No. 06-633

12/7/06

In The

Supreme Court of the United States

PHILIP MORRIS USA, INC., ET AL.,

Petitioners,

v.

STATE OF MINNESOTA,

Respondent.

On Petition For A Writ Of Certiorari To The Minnesota Supreme Court

BRIEF FOR THE RESPONDENT IN OPPOSITION

MIKE HATCH
Minnesota Attorney General
BRADFORD S. DELAPENA
Assistant Attorney General
RITA COYLE DEMEULES
(Counsel of Record)
Assistant Attorney General
445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 296-0692

Attorneys for Respondent

QUESTION PRESENTED

In 1994, the State of Minnesota brought state common law and statutory claims against Petitioners in Minnesota state court. On May 8, 1998, the State and Petitioners entered into a Settlement Agreement, which contained mutual release-of-claims provisions. Seven years later, the Minnesota Legislature enacted legislation that imposed a fee on all cigarettes. Petitioners invoked the continuing jurisdiction of the state court over the Settlement Agreement and brought a motion to enforce that Agreement. Petitioners argued that the Legislature's fee was a "released claim" under the Settlement Agreement and consequently could not be enforced against them or their products without breaching the Agreement and/or violating the Contract Clauses of the United States and Minnesota Constitutions. The State asserted that the fee was a valid legislative exaction not prohibited by the Settlement Agreement. Thus, the threshold issue before the state court was interpretation of the Settlement Agreement. The Minnesota Supreme Court interpreted the contract under state law, including the state-law doctrine of unmistakability, and held that it did not surrender the State's sovereign legislative powers in language "too clear to admit of doubt." Based on that construction, the court summarily rejected Petitioners' state Contract Clause argument, and did not mention the analogous federal clause. Assuming, however, that the state court resolved Petitioners' federal Contract Clause challenge, the question presented is whether the Minnesota Supreme Court properly applied the doctrine of unmistakability in harmony with the protections afforded by the federal Contract Clause.

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OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent State of Minnesota respectfully requests that the Court deny the Petition for Writ of Certiorari seeking review of the Minnesota Supreme Court's opinion and judgment in this case. The Minnesota Supreme Court's opinion is published at 713 N.W.2d 350 (Minn. 2006), and is reproduced in Petitioners' Appendix ("Pet. App.") at Pet. App. 1a-27a. The trial court's Order on Petitioners' Motion for Enforcement of the Settlement Agreement, which is unpublished, is reproduced at Pet. App. 28a-38a.

STATEMENT OF JURISDICTION

Petitioners incorrectly invoke this Court's jurisdiction under 28 U.S.C. § 1257(a). The Minnesota Supreme Court neither addressed nor resolved any federal question. Instead, the state court applied state law to summarily reject Petitioners' state contract clause challenge. Thus, an adequate and independent state ground supports the court's decision and precludes jurisdiction in this Court. *See infra* at 6-13.

STATEMENT OF THE CASE

The State, through its attorney general, brought suit against Petitioners and others in 1994, asserting state common law and statutory claims in connection with Petitioners' marketing and distribution of cigarettes. Pet. App. 3a, 50a, 97a. In May 1998, after a lengthy trial but before the jury returned a verdict, the State and Petitioners entered

into a Settlement Agreement to resolve the State's legal claims. Pet. App. 96a. Among other benefits, that Agreement resolved "all claims" between the State and Petitioners. Pet. App. 107a. The term "claims" was defined as follows:

> [T]he State of Minnesota shall release and forever discharge [Petitioners] . . . from any and all manner of *civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees*, known or unknown, suspected or unsuspected, accrued or unaccrued, *whether legal, equitable or statutory* ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:
>
> > for past conduct, as to any Claims relating to the subject matter of this action . . . ; and
> >
> > for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for

> health care costs allegedly associated with use of or exposure to Tobacco Products.

Pet. App. 107a-08a (emphasis added).

Seven years later, on July 14, 2005, Minnesota's governor signed into law a Tobacco Health Impact Fee effective August 1, 2005. *See* Act of July 14, 2005, ch. 4, art. 4, §§ 1-6, 2005 Minn. Laws (1st Sp. Sess.) 2541-44 (codified at Minn. Stat. § 256.9658) ("the HIF Act"). Pet. App. 43a-44a. The HIF Act imposes a 75-cent per-pack fee on cigarettes. Pet. App. 43a. Minnesota law requires this fee to be passed on to the consumer. Pet. App. 9a. In enacting the HIF Act, the legislature stated that the purpose of the fee was to "recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Pet. App. 43a.

On August 26, 2005, Petitioners moved to enforce the Settlement Agreement in the Minnesota state district court that retained jurisdiction over that Agreement. Pet. App. 89a, 98a. Petitioners argued that, because the Settlement Agreement released them (and their distributors) from any and all "claims" to recover state healthcare costs attributable to tobacco use, enforcement of the HIF breached the Agreement and violated the Contract Clauses of the United States and Minnesota Constitutions. Pet. App. 91a-92a. The State opposed the Motion arguing that, properly construed, the Agreement does not bar collection of the HIF. Respondent's Appendix ("Resp. App.") 46a. The state district court found the HIF Act barred by the Settlement Agreement and granted Petitioners' Motion. Pet. App. 29a-30a.

The State petitioned for review in the Minnesota Supreme Court, arguing that the Settlement Agreement

released only adjudicatory claims and did not prohibit future legislation. Resp. App. 49a-50a. Any other construction, the state argued, would limit the state's sovereign powers and, under state law, such a waiver would have to be set forth in terms "too clear to admit of doubt." Resp. App. 49a. Once the Agreement was properly construed under state law, the State argued, there was no violation of the Settlement Agreement and no impairment under the Contract Clause. Resp. App. 11a-12a, 20a-22a, 50a-51a.

In an Order dated May 16, 2006, the Minnesota Supreme Court first found that Petitioners do not bear the economic burden of the HIF Act, even though one of the express purposes of the Act is recover healthcare costs of the State. Pet. App. 8a-9a. Next, the court recognized that construing the release language with the breadth Petitioners urged would work a surrender of sovereign power. Thus, the court concluded that the state law doctrine of unmistakability announced in *State v. Great Northern Railway Co.*, 119 N.W. 202 (Minn. 1908), *aff'd, Great Northern Railway Co. v. State*, 216 U.S. 206 (1910) applied. Pet. App. 14a, 21a. Concluding that the Agreement did not surrender the State's sovereign power in terms "too clear to admit of doubt," the Minnesota court summarily rejected Petitioners' *state* Contract Clause challenge. Pet. App. 24a-25a. No other constitutional challenge, state or federal, was considered or resolved in the Minnesota Supreme Court's decision.

REASONS FOR DENYING THE PETITION

The Petition does not present a proper occasion for this Court to assert jurisdiction. The Minnesota Supreme Court applied state law doctrines of contract construction to determine that the Agreement did not preclude the state from imposing the fee on Petitioners' products. The court rejected Petitioners' broad reading of the Agreement and then summarily rejected their state constitutional challenge. The court neither addressed nor resolved a federal question. Thus, the jurisdiction that Petitioners invoke under 28 U.S.C. § 1257(a) does not exist.

Second, the Minnesota Supreme Court correctly recognized that the unmistakability doctrine – state and federal – protects state regulatory powers from undue restriction by the Contract Clauses. Thus, even if the court had applied the federal doctrine, it would have done so correctly and in a manner that preserves the protections of the federal Contract Clause.

Third, Petitioners inaccurately portray the lower courts' application of the principles drawn from the plurality opinions in *United States v. Winstar*. As have two federal circuit courts, the Minnesota Supreme Court correctly recognized that on factual situations such as those presented here, the doctrine is properly applied to proprietary contracts. Any uncertainty that Petitioners perceive concerning application of the unmistakability doctrine stems from issues that are not presented by this case; thus, any clarification urged by Petitioners would be purely advisory as it would not apply to the facts presented.

I. ADEQUATE AND INDEPENDENT STATE GROUNDS SUPPORT THE MINNESOTA SUPREME COURT'S DECISION. THE PETITION THEREFORE FAILS TO INVOKE THIS COURT'S JURISDICTION.

The Minnesota Supreme Court construed a settlement agreement governed by *Minnesota state law* that was executed to resolve *Minnesota state law claims* brought in *Minnesota state court*. *See* Pet. App. 96a-97a, 119a. Once it did so, the court summarily rejected Petitioners' argument that the HIF Act violated "the Contract Clause of the Minnesota Constitution, Minn. Const. art. I, § 11." Pet. App. 24a.[1] In rendering its decision, the Minnesota Supreme Court applied state law rules of contract construction including the rule of construction from *State v. Great Northern Railway*, 119 N.W. 202 (Minn. 1908), the federal analogue of which was explicated by this Court in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), to reject Petitioners' interpretation of the Agreement. *See* Pet. App. 21a (noting that language of Settlement Agreement did not meet the state law rule of *Great Northern Railway*). In short, the Minnesota Supreme Court addressed and resolved a state law question by applying state law, even though it also discussed an analogous federal decision. Because the Minnesota Supreme Court did not address or decide any federal question, this Court does not have jurisdiction.

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[1] Petitioners also challenged the HIF Act under Article I, § 10, clause 1 of the United States Constitution. *See* Pet. App. 92a. As explained *infra*, however, the Minnesota Supreme Court specifically and plainly addressed only the Minnesota Constitution's prohibition against contract impairment. Petitioners raised no other federal challenges.

Section 1257 constrains this Court's review of the final judgment of a state court. *See* 28 U.S.C. § 1257(a). It is axiomatic that this Court will not review a state court decision unless a federal question has been raised *and decided* by that court. *See Coleman v. Thompson*, 501 U.S. 722, 729 (1991) ("This Court will not review a question of federal law decided by a state court if the decision of that court rests on a state law ground that is independent of the federal question and adequate to support the judgment."); *Herb v. Pitcairn,* 324 U.S. 117, 125 (1945) ("This Court from the time of its foundation has adhered to the principle that it will not review judgments of state courts that rest on adequate and independent state grounds."). The reason for this rule is "so obvious that it has rarely been thought to warrant statement." *Herb*, 324 U.S. at 125. "Because this Court has no power to review a state law determination that is sufficient to support the judgment, resolution of any independent federal ground for the decision could not affect the judgment and would therefore be advisory." *Coleman*, 501 U.S. at 729; *see also Herb*, 324 U.S. at 126 (noting that this Court's jurisdiction is limited to correcting state court judgments that "incorrectly adjudge federal rights").

The longstanding restraint on this Court's jurisdiction over state court judgments bars granting this Petition. The Settlement Agreement is governed by, and was construed under, Minnesota law. *See* Pet. App. 119a. The "interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 60, n.4 (1995) (*quoting Volt Info. Servs., Inc. v. Bd. of Tr. of Leland Stanford Junior University*, 489 U.S. 468, 474 (1989)); *see also Memphis Natural Gas Co. v. Beeler*,

315 U.S. 649, 654 (1942) (noting that "meaning and effect of contract" are "local questions" which this Court does not review).[2] Here, the Minnesota Supreme Court applied state law, first to construe the HIF Act, *see* Pet. App. 8a-9a; and then to construe the Settlement Agreement language. *See* Pet. App. 21a (noting commonality of language used in release provision); *id.* at 22a-23a (construing language in light of Minnesota's cigarette pricing scheme).[3]

The construction the Minnesota Supreme Court reached obviated the need to reach Petitioners' state or federal Contract Clause arguments. *See Fox Film Corp. v. Muller*, 296 U.S. 207 (1935). In *Fox Film*, the Minnesota Supreme Court construed contracts that admittedly violated federal antitrust laws to determine whether the illegal clause could be severed from those contracts. *Id.* at 208-09. After the court rejected severance, thus invalidating the contracts, the plaintiff petitioned this Court, asserting that the federal antitrust question was decided as part of the contract construction. *Id.* at 209. This Court disagreed:

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[2] While the decision in *Memphis Natural Gas* suggested that a state court's decision on state law could be reviewed if that law was used to evade federal law, 315 U.S. at 654, Petitioners do not allege, nor could they, that the Minnesota Supreme Court addressed the state constitutional claim only as a means to evade the federal constitutional claim.

[3] Petitioners thus have no basis for their blithe assertion that, "If the unmistakability doctrine had not been applied below, the [HIF Act] indisputably would have been found to impair the settlement agreement." Pet. at 15. In addition to plain meaning construction, the State and amicus provided the Court with several alternative state law grounds on which Petitioners' arguments to avoid the HIF could be rejected. *See* Resp. App. 24a-25a, 68a-85a, 106a-115a.

> The construction put upon the contracts did not constitute a preliminary step which simply had the effect of bringing forward for determination the federal question, but was a decision which automatically took the federal question out of the case if otherwise it would be there. The nonfederal question in respect of the construction of the contracts and the federal question in respect of their validity under the Anti-Trust Act were clearly independent of one another. The case, in effect, was disposed of before the federal question said to be involved was reached. A decision of that question then became unnecessary; and whether it was decided or not, our want of jurisdiction is clear.

Id. at 211 (citations omitted).

Here, the Minnesota court's "nonfederal" contract construction established that the terms of the Agreement were not implicated by the HIF Act. This construction allowed the court to summarily reject Petitioners' state constitutional challenge without analysis. *See* Pet. App. 24a-25a ("Because we construe the settlement agreement not to waive the legislature's authority to enact future legislative revenue measures to recover health care costs, the enactment of the [HIF] did not impair that agreement and therefore did not violate the [Minnesota] Contract Clause."). The court's construction likewise obviated any need to address Petitioners' federal Contract Clause argument. Consequently, the federal constitutional challenge asserted in the trial court – which was neither addressed nor resolved by the Minnesota Supreme Court – was "automatically . . . out of the case if otherwise it would

be there" based on the nonfederal contract construction. *Fox Film Corp.*, 296 U.S. at 211.[4]

For this reason, Petitioners' assertion that the Minnesota Supreme Court reviewed a federal question simply because Petitioners asserted it is wrong. *See* Pet. at 8, n.2 citing *Delaware v. Prouse*, 440 U.S. 648 (1979). In *Delaware*, the state court began with the federal constitutional claim, "analyzed the various decisions interpreting the Federal constitution, concluded that the Fourth Amendment [was infringed], and summarily held that the State Constitution was therefore also infringed." *Id.* at 652-53. The lower court's decision thus "depended upon [its] view of the reach of the Fourth and Fourteenth Amendments." *Id.* at 653.

Review in this Court was therefore proper. Accepting jurisdiction in this case merely because Petitioners asserted a federal claim, in contrast, would disregard the limitations of Section 1257 and undermine the adequate and independent state grounds rule. Indeed, the Court has already rejected this unrestricted view of federal question jurisdiction. *See Enter. Irrigation Dist. v. Farmers' Mut. Canal Co.*, 243 U.S. 157, 165 (1917) (dismissing for "want of jurisdiction" even though federal constitutional challenges were part of case, where state law issues were addressed separately and this Court was "not at liberty to inquire whether the ruling is right or wrong").

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[4] The state and federal contracts clauses are interpreted similarly. *See* Pet. at 8, n.2. Thus, the Minnesota court's decision would not change *even if* the federal claim was treated similarly, i.e., summarily rejected. *See Coleman*, 501 U.S. at 729 (noting that independent federal ground "that could not affect the judgment" does not support jurisdiction).

Likewise, this Court has no need to determine the contract terms to which the federal Contract Clause might apply. This Court assumes jurisdiction to decide the existence and terms of a contract only when a state court addresses and resolves a federal Contract Clause claim. *See Gen. Motors Corp. v. Romein*, 503 U.S. 181, 187 (1992) (noting that existence of contract is a federal question for purposes of contract impairment claim asserted under federal constitution); *Mun. Investors Ass'n v. City of Birmingham*, 316 U.S. 153, 157 (1942) (noting this Court's obligation "to determine for itself the basic assumptions upon which interpretations of the Federal Constitution rest"); *State of Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 98-99 (1938) (lower court admitted that constitutional claim was based on federal constitution, thus supporting Court's jurisdiction to determine the terms of the contract). Since the Minnesota court summarily rejected only a state constitutional challenge, an adequate and independent state ground precludes this Court's jurisdiction.

The Minnesota Supreme Court's state law resolution is also adequate and independent notwithstanding that court's discussion of *United States v. Winstar Corp.*, 518 U.S. 839 (1996). The Minnesota Supreme Court relied on *Winstar* "as it would on the precedents of all other jurisdictions[.]" *Michigan v. Long*, 463 U.S. 1032, 1040 (1983). It *decided* the contract construction issue, however, exclusively by reference to state doctrine: "We cannot say that the language of the settlement agreement effects such a waiver of the state's sovereign powers in language 'too clear to admit of doubt.'" Pet. App. 21a (*quoting Great N.*

Ry. Co., 119 N.W. at 205).[5] Thus, even if this Court were to conclude, as Petitioners urge, that *Winstar's* plurality opinions should be clarified, such an effort would be purely advisory as it would have no effect below. The Minnesota Supreme Court could reach the same decision by once again construing the contract under the state law unmistakability doctrine from *Great Northern Railway*.

Finally, there is an additional reason to decline review. The State argued below that because the Agreement resolved only common law and statutory claims the State had asserted in its proprietary capacity, the Agreement's boilerplate release-of-claims provision was simply a conventional promise not to sue, and could not reasonably be construed as a surrender of sovereign power. *See* Resp. App. 52a-58a. The state court adopted this reasoning in part. *See* Pet. App. 19a ("we cannot help but note that the phrase 'liabilities of any nature whatsoever' (or similar language) is commonly used in general release forms in disputes having nothing to do with any sovereign power."). Although this construction of the Agreement would have been sufficient to resolve the case, the state court applied the Minnesota unmistakability doctrine in an abundance of caution, determining that *even if* the release provision were somehow ambiguous, it could not surrender sovereign power. *See* Pet. App. 21a. The concurring Justice, however, found no need to apply the doctrine:

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[5] The absence of a statement disclaiming any federal basis for the state court's decision, *see Long*, 463 U.S. at 1040, does not require this Court to assume jurisdiction. The federal constitution was not mentioned in the decision below. In *Long*, in contrast, the state court "relied exclusively on its understanding" of federal law and "not a single state case was cited." *Id.* at 1043.

> I read the settlement agreement and its release of "claims" to unambiguously cover no more than the claims the state brought or could have brought against [Petitioners] in the 1994 tobacco litigation or could bring in future litigation. Imposition of the Health Impact Fee does not create such a "claim." Therefore, I would hold that under the unambiguous language of the settlement agreement, imposition of the Health Impact Fee did not violate the settlement agreement.

Pet. App. 27a (footnote omitted) (Page, J., specially concurring). If this Court agreed with this reasoning, it would have no occasion to apply the unmistakability doctrine, federal or otherwise, and thus could not clarify federal law. *Cf. Winstar*, 518 U.S. at 880, n.24 (1996) (noting that doctrine may not be applicable where "normal rules of construction" may dispose of proposed construction).

Because the Petition presents no federal question, it should be dismissed.

II. THE MINNESOTA SUPREME COURT'S DECISION DOES NOT CONFLICT WITH THIS COURT'S CONTRACT CLAUSE JURISPRUDENCE.

Petitioners claim that by applying the unmistakability doctrine, the Minnesota Supreme Court deviated from this Court's Contract Clause jurisprudence. This is plainly incorrect. The unmistakability doctrine developed as a part of this Court's Contract Clause jurisprudence, and in no way vitiates the protection federal law affords contracts. Although the state court applied Minnesota's version of the doctrine, that application is fully consistent with this Court's application of the federal doctrine.

A. The Federal Unmistakability Doctrine Is Part Of This Court's Contract Clause Jurisprudence.

The Contract Clause provides that, "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. Const., art. I, § 10. The Clause limits state power "when its exercise effects substantial *modifications* of private contracts." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978) (emphasis added). As relevant here, a state may not enter a contract, then use its legislative power to substantially modify contractual obligations.

The federal unmistakability doctrine developed as a part of this Court's Contract Clause jurisprudence "to protect state regulatory powers." *United States v. Winstar Corp.*, 518 U.S. 839, 874 (1996) (plurality opinion). "Although [the Contract] Clause made it possible for state legislatures to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments." *Id.* Thus, the unmistakability doctrine is a canon of construction that rejects "implied governmental obligations in public contracts," *id.* at 874, thereby limiting the extent to which the Contract Clause curtails state powers.

> Under this rule that all public grants are strictly construed, we have insisted that nothing can be taken against the State by presumption or inference, and that neither the right of taxation, nor any other power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken.

Id. at 874-75 (ellipsis in original) (internal quotation marks and citations omitted). Because the unmistakability doctrine construes contracts to protect state regulatory powers, its applicability "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power. . . . " *Id.* at 879.

B. The Minnesota Supreme Court's Decision Is Correct And Is In Harmony With This Court's Contract Clause Jurisprudence.

As already noted, the Minnesota Supreme Court applied the unmistakability doctrine as a matter of state law rather than federal law. *See supra* at 6-12. But even if the state court had applied the federal doctrine, its application would be correct and in perfect harmony with this Court's Contract Clause jurisprudence.

From the start, Petitioners have alleged that the provision of the Settlement Agreement by which the State released all of its past, present and future "claims" (the "State's Release") prevents the Minnesota Legislature from imposing on Petitioners, and the Revenue Department from enforcing against them, the 75-cent per-pack HIF on Petitioners' products.[6] Attempting to avoid application of

[6] *See, e.g.*, Pet. App. 10a (Petitioners "argue that the imposition of the fee violates the settlement agreement"); *id.* at 12a (Petitioners assert the HIF "cannot be enforced against them, or, apparently, their products"); *id.* at 18a (Petitioners "argue that the consequence of the promise made by the state is that the exercise of sovereign power by the legislature is unenforceable as to them and their products"); *id.* ("the very relief [Petitioners] seek requires the state either to exempt [Petitioners] from the exercise of the state's sovereign powers to tax and to regulate, or to surrender those powers with respect to the cigarette industry altogether").

the unmistakability doctrine, Petitioners asserted – without authority – that the doctrine does not apply to contracts a state enters in its proprietary capacity, such as the Settlement Agreement. The state court rejected this argument. *See* Pet. App. 16a, n.5. In line with this Court's cases, the state court properly held that application of the doctrine instead turns on the nature of the government's obligations "and the consequences of enforcing them."[7] *Id.* Accordingly, the state court concluded that "to construe the settlement agreement as [Petitioners] urge, that is, to waive the legislature's authority to enact revenue measures to recover tobacco-related health care costs, would be a surrender of the legislature's sovereign power." Pet. App. 14a. The court correctly determined that Petitioners' allegations implicated the doctrine. *See* Pet. App. 14a, 20a.

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[7] Petitioners' assertion that the unmistakability doctrine does not apply to contracts a state enters in its proprietary capacity is plainly incorrect, and is unsupported by any of the authorities Petitioners cite. *See* Pet. at 11-15 & nn.4-5. First, this Court has applied the doctrine to proprietary contracts. *See infra* at 19-21 (discussing *Merrion v. Jicarilla Apache Tribe*, 453 U.S. 130 (1982)). Second, the two cases Petitioners discuss at length, *Murray v. Charleston*, 96 U.S. 432 (1877) and *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977) show only that some Contract Clause cases involving proprietary contracts do not require application of the unmistakability doctrine (because the plaintiff does not allege that the disputed contract surrenders sovereign power, but only that legislative power was used to modify a contractual obligation). *See* 96 U.S. at 444-45; 431 U.S. at 23-24. These cases neither hold nor suggest that the doctrine does not apply to proprietary contracts. Finally, Petitioners' assertion is not supported by cases stating the general rule that government contracts are interpreted and construed like private contracts. *See* Pet. at 14. The unmistakability doctrine is an exception to the general rule, and applies whenever enforcement of a government obligation would impair a state's sovereign power. *See Winstar*, 518 U.S. at 879; *id.* at 920-21 (Scalia, J., concurring in the judgment).

The state court correctly applied the doctrine. The court recognized that it must "examine the language of the [State's Release] to determine not just whether it supports a waiver of the legislature's power to enact future revenue measures expressly intended to address the costs of tobacco-related health care, but whether it does so in unmistakable terms." Pet. App. 20a. The court stated that in doing so, it was

> guided by the principles of construction stated in *Great Northern Railway* and *Winstar*. We are not to draw inferences from indefinite language or make presumptions from uncertain language. *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *Winstar*, 518 U.S. at 874, 116 S.Ct. 2432. Rather, the settlement agreement is to be strictly construed, and any waiver of sovereign power must be "in language and terms too clear to admit of doubt." *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205; *see also Winstar*, 518 U.S. at 874, 116 S.Ct. 2432.

Pet. App. 20a. These principles fully conform to *Winstar*.[8]

The state court applied the doctrine's rule of strict construction to the State's Release and concluded that it did not surrender the state's sovereign police or taxing powers. *See* Pet. App. 21a. The court set forth its reasoning as follows:

> Application of the unmistakability doctrine compels the conclusion that the settlement agreement

[8] Moreover, the structure of the state court's citations confirms that the court was applying the state version of the unmistakability doctrine set forth in *Great Northern Railway*, although it also drew support by analogy from the federal version of the doctrine elaborated in *Winstar*.

> cannot be construed to waive the legislature's sovereign authority under the tax and police powers to enact revenue measures, even if earmarked for payment of tobacco-related health care costs. We cannot say that the language of the settlement agreement effects such a waiver of the state's sovereign powers in language "too clear to admit of doubt." *Great N. Ry. Co.*, 106 Minn. at 322, 119 N.W. at 205. Although the phrase "liabilities of any nature whatsoever" is broad, it is insufficiently specific to meet the requirements of the unmistakability doctrine. The language mentions neither the police nor the taxing power. Nor does the language expressly waive the state's right to impose future taxes or fees on [Petitioners] or their products, or expressly waive the state's right to further regulate the cigarette industry in the future.

Pet. App. 21a.[9] This reasoning is fully consistent with *Winstar*. *See* 518 U.S. at 878-79.

Confronted with Petitioners' claim that the Settlement Agreement surrendered state sovereign powers, the state court strictly construed relevant contract provisions and determined that they worked no such surrender. The court accordingly concluded that the Agreement did not "preclude legislative enactment of revenue measures directed at recovering future tobacco-related health care costs generally or the Health Impact Fee in particular." Pet. App. 24a. The state court's construction of the Agreement obviated the need to reach or analyze Petitioners' state or

[9] The full text of the State's Release quoted in this excerpt ("liabilities of any nature") is in Petitioners' appendix. *See* Pet. App. 10a; *see also supra* at 2-3.

federal contract clause arguments. *See* Pet. App. 19a, n.6 ("the unmistakability doctrine serves the dual purposes of limiting contractual incursions on a State's sovereign powers and of avoiding difficult constitutional questions about the extent of State authority to limit the subsequent exercise of legislative power. It serves both of those salutary purposes here. . . . ") (internal quotation marks and citation omitted).[10]

In addition to being manifestly correct, the state court's decision is fully consistent with this Court's Contract Clause jurisprudence. Most importantly, the state court's decision here does not – as Petitioners wrongly assert – allow states to breach contracts that are found not to surrender sovereign powers. *See, e.g.*, Pet. at 10, 16 (so alleging).

A brief discussion focusing on two of this Court's cases is sufficient to illustrate the point. In the first case, *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982), the Court considered whether long-term mineral leases between the Jicarilla Apache Tribe and non-Indian petroleum producers precluded the Tribe from later imposing a severance tax on petroleum produced by the lessees. *Id.* at 133. Twenty-one non-Indian petroleum producers ("lessees") entered into proprietary mineral leases with the Tribe granting them " 'the exclusive right and privilege to

[10] In addition to the Contract Clause challenges, the Minnesota Supreme Court was confronted with constitutional issues involving the separation of powers and the Minnesota Constitution's express prohibition against contracting away the taxing power. Resp. App. 66a-69a. The Governor, as amicus, also asserted that Petitioners' proposed constructions implicated state constitutional limits on the state attorney general's authority to contractually restrict the state's future exercise of sovereign powers. *See* Resp. App. 99a-105a.

drill for, mine, extract, remove, and dispose of all the oil and natural gas deposits in or under' the leased land. . . . " *Id.* at 135; *see also id.* at 145 (noting "the Tribe's role as commercial partner" in leases); *id.* at 146 (characterizing the leases as "the sovereign's commercial agreements"). The Tribe subsequently passed an ordinance "imposing a severance tax on oil and gas produced on tribal land." *Id.* at 135-36. The lessees "sought to enjoin enforcement of the tax by either the tribal authorities. . . ." *Id.* at 136. The federal district court permanently enjoined enforcement of the tax, but the court of appeals reversed. *Id.* This Court affirmed.

The Court concluded that the absence of any reference to taxation in the leases did not impair the Tribe's taxing authority.[11] The Court explained that "[c]ontractual arrangements remain subject to subsequent legislation by the presiding sovereign," *id.* at 147 (citations omitted), and that "sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." *Id.* at 148. The Court emphasized that this subsisting sovereign authority is unaffected by proprietary agreements: "Even where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government's power to tax remains unless it 'has been specifically surrendered in terms which admit of no other

[11] The Court first concluded that the Tribe's inherent authority to impose the severance tax was not affected by the Tribe's status as the lessor of mineral rights. "The mere fact that the government imposing the tax also enjoys rents and royalties as the lessor of the mineral lands does not undermine the government's authority to impose the tax." *Id.* at 138.

reasonable interpretation.'" *Id.* at 148 (quoting *St. Louis v. United R. Co.*, 210 U.S. 266, 280 (1908)). Applying the unmistakability doctrine, the Court pointedly refused to infer waiver of the Tribe's taxing power from silence. "To presume that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in a commercial agreement turns the concept of sovereignty on its head. . . . " *Id.* at 148.[12]

Merrion confirms that the Minnesota court's decision is consistent with this Court's application of the unmistakability doctrine. *See Winstar*, 518 U.S. at 876-77 (discussing this Court's cases applying the doctrine, including *Merrion*). Here, as in *Merrion*, a government entity entered into a proprietary agreement with private parties. Like the leases in *Merrion*, the Settlement Agreement in this case is silent about the state's taxing power. As did this Court in *Merrion*, the state court in this case applied the unmistakability doctrine and refused to infer a waiver of sovereign power from silence or ambiguity. In both cases, the unmistakability doctrine served its intended purposes of protecting government regulatory authority "and of avoiding difficult constitutional questions about

[12] Petitioners seek this very inversion, for they suggest that a state must – even when entering proprietary agreements – *expressly reserve* the power to legislate. *See* Pet. at 10 (challenging state's right to enact legislation "that is not expressly and specifically barred by the contract"). As *Winstar* noted, however, the dispositive question for unmistakability purposes is not whether the contract *reserves* sovereign power; it is instead whether the contract unmistakably *waives* such power. *See* 518 U.S. at 877-78.

the extent of state authority to limit the subsequent exercise of legislative power." *Winstar*, 518 U.S. at 875.[13]

Murray v. Charleston demonstrates the more general proposition that a state never has the power to breach its contracts, proprietary or otherwise. This Court held in *Murray* that the Contract Clause prohibited the City of Charleston from using legislative power to reduce the interest rate it had previously promised to pay to holders of municipal stock certificates. 96 U.S. 432, 444 (1877).

In *Murray*, the City of Charleston issued municipal stock certificates that provided for payment by the city of principal plus six percent interest. *Id.* at 439. The city later passed ordinances: (a) imposing a two-percent tax on real and personal property, and (b) ordering the city treasurer to pay four rather than six percent interest to stockholders, purportedly as a means of collecting the two-percent tax. *Id.* Plaintiff Murray brought an action under the Contract Clause complaining "that the city has not fully performed its contracts according to their terms, that it has paid only four per cent interest instead of six per cent, which it promised to pay. . . ." *Id.* at 442. The city responded that it "possessed the power of taxation when the contracts were made, that by the contracts the city did not surrender this power, that, therefore, the contracts were subject to its possible exercise, and that the city ordinances were only an exertion of it." *Id.* at 444.

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[13] Although the original purpose of the unmistakability doctrine was "avoidance" of Contract Clause issues, the Court has since applied the doctrine to avoid addressing limitations on government authority "independent of the Contract Clause." *See Winstar*, 518 U.S. at 875-76.

The Court framed the issue as whether the ordinances "did impair the obligation of the city's contract with the plaintiff." *Id.* at 443. The Court noted that "[t]he solution of this question depends upon a correct understanding of what that obligation was." *Id.* The Court found that the city had undertaken to pay plaintiff six percent interest, and that the contract "contained no reservation or restriction of the duty described." *Id.* The ordinances, however, purported to reduce the interest rate payable by the city from six to four percent. *Id.* Finding a "manifest" impairment of the city's payment obligation, *id.*, the Court invalidated the ordinances under the Contract Clause. *Id.* at 448.

Importantly, the Court did not "question the existence of [the city's] power to levy taxes as claimed, nor the subordination of contracts to it. . . . " *Id.* at 444. The issue, however, was not whether the city could levy the property tax, but was instead whether it could use legislative authority to alter its contractual obligation to pay stockholders six percent interest. The Court strongly affirmed the city's power to levy the property tax and collect it in the normal manner, holding that the city

> may undoubtedly tax any of its creditors within its jurisdiction for the debt due to him, and regulate the amount of the tax by the rate of interest the debt bears, if its promise be left unchanged. A tax thus laid impairs no obligation assumed. It leaves the contract untouched.

Id. at 445. The city could not, however, use its taxing power to "convert its undertaking to pay a debt bearing six per cent interest into one bearing only four." *Id.* at 447. Under the Contract Clause, the city could not "by its own ordinances, under the guise of taxation, relieve itself from

performing to the letter all that it has expressly promised to its creditors." *Id.* at 448.[14]

The state court's decision in this case is consistent with *Murray*, and does not allow states to breach contracts, proprietary or otherwise. As in *Murray*, the state court began its state Contract Clause analysis by determining the exact nature of the contractual obligation in question. *See* Pet. App. 9a. As in *Murray*, the state court recognized that contracts generally remain subject to a sovereign's taxing and police powers. *See* Pet. App. 14a-16a. And as in *Murray*, the court determined whether the state's obligation had been impaired by the subsequent exercise of legislative power. *See* Pet. App. 24a-25a. Although this Court invalidated the ordinances in *Murray*, whereas the state court upheld the HIF, this does not mean that the state court was unwilling to enforce the Contract Clause. It shows only that no contractual obligation undertaken by the state was impaired by imposition of the HIF.

Petitioners' assertion that this decision "conflicts with nearly 130 years of this Court's Contract Clause precedent," Pet. at 10, reflects a misunderstanding of both that precedent and the unmistakability doctrine's part therein. Although the states in both *Merrion* and *Murray* retained all of their sovereign powers, neither state was allowed to use those powers to breach contracts. Here, likewise, the State's retention of sovereign powers does not confer

[14] Petitioners wrongly assert that the City of Charleston breached its contract "by levying a tax." *See* Pet. at 12. This is plainly incorrect. The *Murray* Court made clear that the city could levy and collect the tax without violating its contract, so long as the city honored its contractual obligation to pay stockholders six percent interest before attempting to collect the tax. *See* 96 U.S. at 445-46.

authority to breach the Agreement. In any event, Petitioners' claim rests firmly on the erroneous theory that the State of Minnesota *failed to retain* its sovereign powers, a theory expressly rejected by the unmistakability doctrine.

The Contract Clause prevents states from using legislative power to substantially modify contracts to which they are parties. The unmistakability doctrine does not in any way vitiate this protection. Instead, the doctrine is a rule of contract construction requiring that government obligations be strictly construed so as to limit the extent to which the Contract Clause curtails state regulatory powers. Government contracts – once properly construed – receive the full measure of Contract Clause protection. Petitioners' assertion that the state court's decision allows states to impair contracts is incorrect, and should be rejected.

III. THIS COURT SHOULD DECLINE REVIEW BECAUSE THE PRESENT CASE DOES NOT PROVIDE A VEHICLE FOR RESOLVING ANY CONFUSION THAT MAY EXIST AMONG THE LOWER COURTS CONCERNING APPLICATION OF THE UNMISTAKABILITY DOCTRINE AND THE MEANING OF *WINSTAR*.

The Court should decline review because the present case plainly implicates the unmistakability doctrine and therefore does not provide a vehicle for resolving any confusion that might exist among the lower courts concerning its proper application. As was shown above, this case is quite similar to *Merrion*. *See supra* at 18-21. In both cases, non-governmental contracting parties specifically alleged that a disputed contract prevented a sovereign from enacting or enforcing laws. *Merrion*, 455 U.S. at

136; Pet. App. 10a, 12a, 18a. There is simply no question that the doctrine applies under these circumstances. *See Winstar*, 518 U.S. at 880; *see also id.* at 878-79 (doctrine applies "when the Government is subject either to a claim that its contract has surrendered a sovereign power . . . or to a claim that cannot be recognized without creating an exception from the exercise of such a power. . . . ").[15]

The Court should decline review for additional reasons as well. First, Petitioners perceive confusion among the lower courts principally because Petitioners themselves misread the plurality opinion in *Winstar*. The plurality does not, as Petitioners assert, make application of the unmistakability doctrine turn on a "two-step inquiry" that begins with whether the disputed contract is "proprietary." *See* Pet. at 16-17 (positing two-step inquiry).

As an initial matter, the plurality specifically *held* that "application of the doctrine . . . turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government." *Winstar*, 518 U.S. at 879. The plurality noted that, "[s]ince the criterion looks to the effect of a contract's enforcement, the particular remedy sought is not dispositive . . . . " *Id.*

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[15] One lower court, although noting some uncertainty about how the doctrine might apply in particular circumstances, commented: "It is clear, however, that one of the basic principles underlying the doctrine is the concern that it would be unreasonable to presume, in the absence of an express contractual provision, that a sovereign intended a contractual waiver of a basic sovereign power." *Tamarind Resort Assocs. v. Gov't of the Virgin Islands*, 138 F.3d 107, 112 (3d Cir. 1998) (citing *Winstar*, 518 U.S. at 920-21 and *Merrion*, 455 U.S. at 148). The *Tamarind* court's citation to *Merrion* demonstrates that the lower courts have no doubt about the doctrine's application to paradigmatic situations like the one presented in this case.

Application of the doctrine "will therefore differ according to the different kinds of obligations the Government may assume and the consequences of enforcing them." *Id.* at 880. After setting forth examples in which the doctrine clearly would and would not apply, the plurality noted: "Between these extremes lies an enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government." *Id.* Rather than establishing the "two-step inquiry" perceived by Petitioners, the plurality articulated governing principles, then illustrated that application of those principles to "an enormous variety of contracts" would require a sensitive case-by-case adjudication. *Id.*

More importantly, Petitioners are simply incorrect in asserting that application of the doctrine turns on whether a contract is proprietary. *See, e.g.*, Pet. at 16. As was discussed above, this Court has itself applied the doctrine to a proprietary contract. *See, e.g.*, *Merrion*, 455 U.S. at 145-48. Moreover, as Petitioners themselves note, two Circuit Courts have applied the doctrine to proprietary contracts since the Court decided *Winstar*. *See* Pet. at 18 (citing *Tamarind Resort Assocs. v. Gov't of the Virgin Islands*, 138 F.3d 107, 109, 112 (3d Cir. 1998) and *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1579 (Fed. Cir. 1997), *cert. denied*, 524 U.S. 951 (1998)). The state court's application of the doctrine here is consistent with these authorities. The lower courts plainly understand that, under the proper circumstances, the doctrine applies to proprietary contracts. There is no confusion on this point; Petitioners are simply wrong.

Second, even if there is some confusion among the lower courts concerning how *Winstar* or the unmistakability doctrine should apply *to factual situations not presented*

here, this case obviously provides no occasion to address such confusion. Petitioners cite a handful of cases in which lower courts indicate some uncertainty about how either *Winstar* or the unmistakability doctrine should apply to certain classes of contracts. *See* Pet. at 18-19 & n.7; *see also Tamarind Resort Assocs.*, 138 F.3d at 112 ("It is somewhat unclear . . . as to the type of contract to which the unmistakability doctrine applies."). They cite academic authorities to the same effect. *See* Pet. at 19-20. Given the absence of a majority opinion in *Winstar* and the fact that the Court was somewhat fragmented, it is not surprising that some lower courts feel some uncertainty. This case, however, which involves a paradigm application of the unmistakability doctrine, furnishes no occasion to clarify how the doctrine should apply to non-paradigmatic facts.

An example may be useful. In *Winstar* a four-justice plurality[16] determined that the unmistakability doctrine does not apply where, as in *Winstar*, the disputed contract could be "reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of" government power. *Winstar*, 518 U.S. at 880. Three justices who concurred in the judgment disagreed with the latter restriction, and would have held the doctrine applicable even to so-called risk-shifting agreements. *See id.* at 919-20 (Scalia, J., concurring in the judgment).[17] The two dissenting justices would have held the doctrine applicable to all government

[16] Justice Souter, joined by Justices Stevens, O'Connor and Breyer.

[17] Joined by Justices Kennedy and Thomas.

contracts including risk-shifting agreements. *See id.* at 926-27 (Rehnquist, C.J., dissenting).[18]

A principal point of disagreement in *Winstar*, then, was whether the unmistakability doctrine applies to risk-shifting agreements.[19] The concurring and dissenting justices would have held in the affirmative, and would thus have given the doctrine broader application than did the plurality. It is therefore to be expected that lower courts are somewhat uncertain about the doctrine's application to risk-shifting agreements. That issue is not presented here, however. The state court correctly determined that the Settlement Agreement in this case is not a risk-shifting agreement, and that Petitioners' proposed construction of the Agreement would directly limit state sovereign powers. *See* Pet. App. 10a, 12a, 18a. Under the circumstances, it appears that all nine *Winstar* justices would have applied the unmistakability doctrine to the present case. Plainly, this case does not provide a suitable vehicle for clarifying the law, even assuming such clarification is necessary.

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[18] Joined by Justice Ginsburg.

[19] The lower courts plainly perceive this disagreement. *See, e.g., Tamarind Resort Assocs.*, 138 F.3d at 112; *Yankee Atomic Elec. Co.*, 112 F.3d at 1578-79; *Gen. Dynamics Corp. v. United States*, 47 Fed. Cl. 514, 535-36 (2000).

CONCLUSION

For all the foregoing reasons, the Petition of Philip Morris USA, Inc. and the joining Petitioners should be denied.

Dated December 7, 2006

Respectfully submitted,

MIKE HATCH
Attorney General
State of Minnesota
BRADFORD S. DELAPENA
Assistant Attorney General
RITA COYLE DEMEULES
(*Counsel of Record*)
Assistant Attorney General
445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 296-0692

Attorneys for Respondent
The State of Minnesota

No. A05-2540

STATE OF MINNESOTA
IN SUPREME COURT

The State of Minnesota,
by Hubert H. Humphrey III,
its then Attorney General, *et al.*,

Petitioner,

vs.

Philip Morris USA, Inc., *et al.*,

Respondents.

STATE'S REPLY BRIEF

EDWARD B. MAGARIAN
PETER SIPKINS
Dorsey & Whitney LLP
50 South Sixth Street,
Ste. 1500
Minneapolis, MN 55402-1498
(612) 340-7873

DAVID F. HERR
MARY R. VASALY
Maslon Edeman Borman
& Brand, LLP
3300 Wells Fargo Center
90 South Seventh Street
Minneapolis, Mn 55402
(612) 672-8200

MIKE HATCH
Attorney General
State of Minnesota

BRADFORD S. DELAPENA
Assistant Attorney General
Atty. Reg. No. 219046

MICHAEL J. VANSELOW
Deputy Attorney General
Atty. Reg. No. 152754

445 Minnesota Street,
Suite 900
St. Paul, Minnesota
55101-2127
(651) 296-0987
Attorneys for Petitioner

MURRAY GARNICK
GEOFFREY J. MICHAEL
Arnold & Porter LLP
555 Twelfth Street, NW
Washington, DC 20004-1206
(202) 942-5000
Counsel for Respondent Philip Morris USA, Inc.

ANAND AGNESHWAR
Arnold & Porter LLP
399 Park Avenue
New York, NY 10022-4690
(212) 715-1000
Counsel for Respondent Philip Morris USA, Inc.

ANDREW J. HAILE
JENNIFER K. VAN ZANT
Brooks, Pierce, McLendon, Humphrey & Leonard LLP
PO Box 26000
Greensboro, NC 27420
(336) 373-8850
Counsel for Respondent Lorillard Tobacco Company

SCOTT G. KNUDSON
BRENT R. LINDAHL
Briggs and Morgan
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 977-8400

KAREN A. JANISCH
130 State Capitol
75 Constitution Avenue
St. Paul, MN 55155
(651) 282-3705
Counsel for Amicus Curiae Governor Tim Pawlenty

WALTER A. PICKHARDT
DANIEL J. CONNOLLY
Faegre & Benson, LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-8622
Counsel for Respondents R.J. Reynolds Tobacco Company & Lorillard Tobacco Company

STEPHEN R. PATTON
ELLI LEIBENSTEIN
JONATHAN E. MOORE
Kirkland & Ellis, LLP
200 East Randolph
Chicago, IL 60601
(312) 861-2000
Counsel for Respondent R.J. Reynolds Tobacco Company

ROBERT J. BROOKHISER
ELIZABETH B. MCCALLUM
Howrey, LLP
1299 Pennsylvania Avenue NW
Washington DC 20004
(202) 783-0800
(612) 339-4295
Counsel for Respondent Commonwealth Brands, Inc.

THOMAS H. BOYD
KARL E. ROBINSON
Winthrop & Weinstine, PA
Suite 3500
225 South Sixth Street
Minneapolis, MN 55402-4629
(612) 604-6400
Counsel for Respondent Council of Independent Tobacco Manufacturers of America

RANDY G. GULLICKSON
JANEL M. DRESSEN
Anthony Ostlund & Baer, P.A.
90 South Seventh Street, Suite 3600
Minneapolis, MN 55402
(612) 349-6969
Counsel for Respondents A.H. Hermel Candy & Tobacco Co.; Henry's Foods, Inc.; Sandstrom's, Inc., Johnson Candy and Tobacco Co. of Brainerd, Inc., M. Amundson Cigar & Candy Co., LLP; The Watson Companies, Inc.; Granite City Jobbing Company, Inc.; Minter-Weisman Co.; Segal Wholesale, Inc.; and Tyler Wholesale, Inc.

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ARGUMENT

I. THE LANGUAGE AND CONTEXT OF THE AGREEMENT DEMONSTRATE THAT THE PARTIES INTENDED IT TO BE A MUTUAL RELEASE OF ADJUDICATORY CLAIMS ONLY.

The parties propose two very different readings of the State's Release. This shows that the provision requires judicial construction. In its *de novo* review of the Agreement, the Court should prefer the State's construction, which will completely resolve this case. The State's reading preserves the plain meaning of the Agreement's terms, honors the context in which those terms appear, comports with settled rules of contract construction, and harmonizes the State's Release with the balance of the Agreement. As will be shown, Defendants' reading of the Release does none of these things.

A. The Court Should Reject As Unsound Defendants' Construction Of The State's Release.

Defendants begin their rather cursory construction argument with an excerpt of the State's Release that is both truncated and elliptical. The truncation isolates the phrase "liabilities of any nature whatsoever" (the "Liabilities Phrase"), *see* Defs.' Br. at 19, and allows Defendants to assign it an expansive meaning starkly incompatible with context. *Id.* at 22 & n.7. The ellipsis artificially places the

Liability Phrase alongside the word "statutory," allowing Defendants to assert that the conjoined terms mean "legislation." *Id.* at 20, 22-23.

Defendants rely on this exaggerated version of the Liability Phrase throughout the rest of their brief. *See, e.g.*, Defs.' Br. at 28, 33, 34. Most importantly, Defendants assert that the State's Release "expressly releases the precise liability that the Health Impact Fee seeks to impose," *id.* at 19, and they argue that it "defin[es] 'claims' in the broadest possible terms to include not just judicial liability, but 'liabilities of any nature whatsoever' including 'statutory' liability." *Id.* at 19-20.

By isolating the Liabilities Phrase, Defendants improperly suppress context. *See Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc.*, 666 N.W.2d 320, 324 (Minn. 2003) (holding that words or phrases should not be "isolated from their context"). The Liabilities Phrase is just one item in a *list* of "claims" in the State's Release. That list reads, in full, as follows:

> civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims"). . . .

App. at 50-51. Settled rules of construction make clear *why* context is critical.

The most important term here is the one defined – "claims" – since it is used throughout the balance of the Agreement. Under the rule of *ejusdem generis*, the term "claims" must be interpreted to include only the sorts of

items that precede it. *See* Minn. Stat. § 645.08(3) (2004) ("general words are construed to be restricted in their meaning by preceding particular words"); *Employers Liability Assur. Corp. v. Morse*, 111 N.W.2d 620, 624-25 (Minn. 1961) (applying rule of *ejusdem generis* to interpret contract). As the State has already shown, the preceding items all relate to adjudication. *See* State's Br. at 15-16. Although Defendants correctly note that the Agreement does not use the term "adjudicatory claims," *see* Defs.' Br. at 19, proper attention to linguistic context reveals that this is an accurate *interpretation* of the term "claims" *as it appears in the State's Release*. It is also consistent with the common and established meaning of the term "claims." *See* State's Br. at 15-17 & n.9.

Context is equally important for properly construing the Liabilities Phrase, which Defendants assign the broadest possible meaning. *See* Defs.' Br. at 22 & n.7. Under the doctrine of *noscitur a sociis*, a phrase capable of several meanings is defined by the words with which the phrase is associated. *See, e.g., Fletcher v. Scott*, 277 N.W. 270, 272-73 (Minn. 1938); *accord Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). Because the terms surrounding the Liabilities Phrase all pertain to adjudication, the Liabilities Phrase does so as well. *See* State's Br. at 19. "[W]hen two or more words are grouped together and ordinarily have a similar meaning, but are not equally comprehensive, the general word will be limited and qualified by the special word[s]." *State v. Suess*, 52 N.W.2d 409, 415 (Minn. 1952). This rule should be applied here to give the Liabilities Phrase its intended scope. *See Utility Elec. Supply, Inc. v. ABB Power T & D Co.*, 36 F.3d 737, 740 (8th Cir. 1994) (noting that doctrine of *noscitur a sociis* is wisely applied to avoid giving statutes unintended

breadth); *Mienes v. Lucker Sales Co.*, 246 N.W. 667, 668 (Minn. 1933) (applying doctrine to limit contract provision to intended scope).

In addition to violating these rules of construction, Defendants' overly expansive interpretation of the Liabilities Phrase is inconsistent with the parties' drafting practice. As the State has already observed, the parties included an additional term – "civil penalties" – in the State's Release. *See* State's Br. at 27. If Defendants were correct that the parties intended "liabilities" *as used in the State's Release* to have its broadest possible meaning, the addition of "civil penalties" would have been entirely unnecessary. Such penalties would plainly have been embraced by the Liabilities Phrase. Because the parties added this extra provision, they clearly did not have in mind Defendants' expansive construction.

In direct contravention of these rules of construction, Defendants combine the disparate terms "liabilities" and "statutory" in an attempt to make "claims" mean "legislation." *See* Defs.' Br. at 22-23. The Court should reject this attempt to expand the State's Release.

First, it requires the improbable inference that, in a section releasing "claims," these sophisticated parties sought to create an exemption from future "legislation," and did so obliquely by using two other words, "liabilities" and "statutory," that reside is two separate clauses. Second, since the Agreement frequently used the word "legislation," *see* State's Br. at 17-18, it requires the conclusion that the parties – without any apparent reason – referred to "legislation" in different ways in different parts of the Agreement. Finally, it is inconsistent with the obvious conclusion that "statutory" claims refers to the very sort of

statutory causes of action asserted in the State Tobacco Lawsuit. *See* App. at 28-36 (State's common law and statutory claims).

When the parties actually addressed legislation in the Agreement, they used that very word. *See* State's Br. at 17-18. Moreover, had the parties wished to provide that Defendants would be exempt from legislation imposing taxes or fees, they would simply have said so. They did not. This Court should conclude that the parties intended the Agreement to work a mutual release of adjudicatory claims only. *See id.* at 13-22.[1]

B. Proper Construction Of The State's Release Undercuts Defendants' Subsidiary Arguments.

1. Because Legislation Falls Outside The Scope Of The Agreement, The Legislature Did Not Unilaterally Alter The Agreement Or Nullify Any Benefit By Imposing The HIF.

Because the Agreement applies exclusively to adjudicatory claims – and not to legislation – the Legislature did not unilaterally alter the Agreement by imposing the HIF. *See* Defs.' Br. at 17, 20-21. Defendants themselves emphasize that "*any* legislation that raises revenue will help offset State health care costs from tobacco." *Id.* at 30 (emphasis in original). It is undisputed that on the very

[1] Each use of the term "claims" in the Agreement and Consent Judgment, again when considered in context, confirms that "claims" refers to *adjudicatory* claims. *See, e.g.*, App. at 37, 39, 43 (§ II.A), 50 (§ III.A), 80 (§ X).

day the Agreement was executed, the Legislature could have quadrupled the cigarette excise tax to offset state healthcare costs. The district court specifically noted that "the Legislature is free to raise revenue by means of a [cigarette] tax, and all parties agree that there would be no basis to override such a tax. . . . " App. at 15.

Defendants thus understood when they executed the Agreement that their products remained subject to legislative exactions. They also appreciated *then* what they say *today* – that the revenue the State raised could be *used* by the State to offset healthcare costs. This conclusively demonstrates that Defendants assumed the risk that the Legislature would impose additional exactions upon their products.[2] Their argument thus amounts to this: (a) the Legislature is free to impose additional exactions upon their products; (b) the State can *use* any revenue generated to offset state healthcare costs; but (c) the Legislature cannot *declare* that the exaction is imposed for this purpose. This cannot be correct. If the Agreement left the Legislature free to tax Defendants' products to offset state healthcare costs, it left the Legislature free to declare its purpose.

Nor does imposing the HIF on Defendants' Distributors nullify the only tangible benefit Defendants received under the Agreement. *See* Defs.' Br. at 15-16, 21, 26. When negotiating and securing a waiver of all state "claims," Defendants fully appreciated that their products would remain subject to legislative exactions. They willingly

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[2] Defendants' contrary assertion that the State assumed the risk that future legislation would be unenforceable is addressed below. *See infra* at 15.

accepted this risk, however, because they perceived that their very existence was threatened by State-initiated lawsuits, and Minnesota's in particular.[3] A release of adjudicatory claims eliminated this risk, and left Defendants free to oppose legislative impositions in the political arena as they had done so successfully in the past.[4]

2. The HIF Is Not A "Claim" For State Healthcare Costs.

The Legislature placed the incidence of the HIF, like that of the cigarette excise tax, upon the distribution and sale of cigarettes. *See* State's Br. at 40 & n.24. Thus, the HIF, like the excise tax, is a legislative exaction upon a commercial activity. The Legislature's declaration that the *purpose* of the HIF is to recover state healthcare costs associated with smoking does not convert the HIF into a "claim" for healthcare costs, "statutory" or otherwise. *See* Defs.' Br. at 30. As Defendants themselves note, all state revenues defray state healthcare costs. The HIF is no

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[3] An R.J. Reynolds press release issued the day the Agreement was signed perfectly illustrates the value Defendants placed on receiving a release of legal claims: "This country has to decide whether one court, like Minnesota, should have the power to bring the industry to the brink of bankruptcy with all the negative implications of such a decision." *See* R.J. Reynolds, "R.J. Reynolds Issues Minnesota Statement," May 8, 1998, http://www.rjrt.com/newsroom/resourcesRJRTview.asp?postID=884 (last visited March 9, 2006).

[4] There is no merit to Defendants' assertion that the Agreement is somehow special because it was not "conditioned on a single payment" and released future claims. *See* Defs.' Br. at 20. Many settlement agreements provide for multiple payments. *See Minnesota Def. Lawyers Ass'n Release Deskbook* 235-51 (Eric J. Magnuson & Stephen O. Plunkett eds. 1998) (discussing structured settlements). Moreover, many agreements contain provisions releasing future claims. *See, e.g., id.*, App. of Forms at F-49, F-54.

more a "claim" for healthcare costs than is the excise tax. Each is a legislative exaction upon the commercial activity of distributing cigarettes, and a distributor's liability for each is measured exclusively by the extent to which the distributor engages in that activity.

If a distributor failed to pay the HIF, were assessed by the Commissioner, appealed, and thus compelled the State to litigate unpaid amounts, the State would proceed exclusively by proving how many packs of cigarettes the distributor had received, just as it would in pursuing unpaid excise tax amounts. The State would *not* offer evidence of state healthcare costs, which would be utterly irrelevant. In either case, the State would be pursuing *unpaid taxes or fees*. It would not be asserting a "claim" for state healthcare costs.

C. Because The Agreement Does Not Surrender The Legislature's Power To Impose An Exaction On The Distribution Of Cigarettes, Imposing The HIF Does Not Breach Or Impair The Agreement.

This case does not involve a Contracts Clause violation because the Act does not attempt to *alter* the obligations of the Agreement. *See* State's Br. at 21 (essence of impairment is alteration). Indeed, the United States Supreme Court found Contracts Clause violations in the two cases discussed by Defendants specifically because legislation *changed the obligations* of existing contracts. *See* Defs.' Br. at 26; *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25-27 (1977) (finding violation where legislature repealed statutory covenant with bondholders); *Murray v. Charleston*, 96 U.S. 432, 443 (1877) (finding violation where city stock certificates promised payment of

six percent interest, but where subsequent ordinance commanded city clerk to withhold, rather than pay, one-third of said interest).

Even if this Court were to conclude that the HIF qualifies as a released "claim" under the Agreement (it does not), this would mean only that the Legislature *breached* the Agreement by imposing the HIF. It would show a *violation* – rather than an *attempted alteration* – of the Agreement. Thus, it would not establish a Contracts Clause violation. As the United States Court of Appeals for the Seventh Circuit has explained: "[W]hen a state repudiates a contract to which it is a party it is doing nothing different from what a private party does when the party repudiates a contract; it is committing a breach of contract. It would be absurd to turn every breach of contract by a state or municipality into a violation of the federal Constitution." *Horwitz-Matthews, Inc. v. City of Chicago*, 78 F.3d 1248, 1250 (7th Cir. 1996) (Posner, J.). Because the Act does not alter the Agreement, there is no impairment. There is no breach, moreover, because the HIF is not a released "claim" under the Agreement.

D. The Scope Of The State's Release Must Be Construed Consistent With The State's Status As A Private Party.

Defendants urge the Court to treat the State "the same way it treats any other contracting party." Defs.' Br. at 18. They note that the State Tobacco Lawsuit was initiated "to vindicate a proprietary interest," *id.* at 6, and they observe that "[a] state may lay aside its sovereignty" when contracting with private parties. *Id.* at 18 n.6. Defendants actually treat the State as a private party in name only, however.

Although Defendants deny claiming that the State "'contracted away' its power to legislate," Defs.' Br. at 31, they later insist that the Agreement binds the State "in all of its manifestations." *Id.* at 36. These assertions are plainly inconsistent, since binding the entire State surely encompasses the State's "power to legislate." In addition, Defendants expressly allege that the Agreement bars the State from *enforcing* its laws. *Id.* at 36-37. Defendants thus stretch the State's Release to bind the State in its sovereign capacity. Defendants' entire approach is incorrect because the State proceeded in its proprietary capacity throughout the State Tobacco Lawsuit. The State *qua* private party cannot bind the State *qua* sovereign.

1. The State Acted In Its Proprietary Capacity When Executing The Agreement.

The State agrees that it acted in its proprietary capacity when bringing and settling the State Tobacco Lawsuit. *See* Supp. App. at 56-57. The State's private-party status must therefore be respected when construing the scope of its release. This principle of consistency is reflected in longstanding Supreme Court precedent:

> [T]he government entering into a contract stands not in the attitude of the government exercising its sovereign power of providing laws for the welfare of the State. The United States as a contractor are not responsible for the United States as a lawgiver. . . . In this court, *the United States can be held to no greater liability than other contractors in other courts.*

Deming v. United States, 1 Ct. Cl. 190, 191 (1865) (emphasis added). *See also United States Trust Co. v. New Jersey*,

431 U.S. 1, 25 n.23 (1977) (concluding that when governments act as private parties rather than as sovereigns, "[t]hey come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons."); *Jones v. United States*, 1 Ct. Cl. 383, 384-85 (1865) ("In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court.").

Because the State must, like Defendants, be treated as a private party, the Agreement's two release provisions must be construed as coextensive. More specifically, the State's Release cannot be read as surrendering sovereign legislative authority not possessed by the State in its proprietary capacity. *See Jones*, 1 Ct. Cl. at 384 ("The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused.").

This same principle of consistent party status defeats Defendants' argument that the Liabilities Phrase *generally* covers civil claims, but in the State's Release covers more. *See* Defs.' Br. at 21. The Court should reject Defendants' attempt to expand that phrase (or the term "claims") to cover the State's sovereign enforcement authority.

2. Because The State Executed The Agreement In Its Proprietary Capacity, It Released Through The Agreement Only The Legal Claims It Held In That Capacity.

Acting in its proprietary capacity, the State commenced the State Tobacco Lawsuit, which asserted common law and statutory claims. All of these claims involved

the invocation of common law or statutory rights equally available to private parties.[5]

Acting again in its proprietary capacity, the State later settled its lawsuit and entered the Agreement. As might any private party, the State made a binding contractual promise to never again assert specified "claims" against Defendants for healthcare costs. In releasing these claims, the State reasoned, as might any private party, that its proprietary interest would be better served by entering the Agreement than by preserving its claims. Like any private party, then, the State promised that it would never again assert "claims" based on rights it possessed in its proprietary capacity (such as a right derived, for example, from the Deceptive Practices Act).

When the State acts in its sovereign capacity, it does not invoke rights and assert "claims." Instead, it exercises the sovereign power to enact and enforce laws. Such power is possessed by neither private parties nor the State acting in its proprietary capacity. The State as sovereign, for example, *enforces* the tax laws administratively by

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[5] In *State by Humphrey v. Philip Morris Inc.*, 551 N.W.2d 490 (Minn. 1996), this Court specifically noted that a private right of action existed for each of the statutory claims the State asserted in the present case:

> In their joint complaint, the State and Blue Cross allege violations of Minnesota's antitrust statute as well as consumer protection statutes relating to consumer fraud, unlawful and deceptive trade practices, and false advertising. Each of these statutes contains specific authorizations for suit *and each creates a private cause of action for any party injured directly or indirectly by a violation of the statute.*

Id. at 495 (emphasis added); *see also id.* at 495-97 (discussing statutory basis for private right of action for each enumerated statutory claim).

auditing taxpayers and assessing sums owed. And, if taxpayers appeal, the State defends its enforcement actions in a judicial setting. *See, e.g.*, Minn. Stat. §§ 270C.03 (Supp. 2005) (Commissioner's powers generally), 289A.35 (2004 & Supp. 2005) (Commissioner's power to assess), 271.06, subd. 1 (Supp. 2005) (taxpayer may appeal orders of Commissioner to tax court).

The State *qua* sovereign has an affirmative duty to enforce the laws. *See, e.g.*, *State ex rel. Decker v. Montague*, 262 N.W. 684, 689 (Minn. 1935) ("The Governor, under his oath of office, is bound to enforce the law. . . . "). Although the Executive has substantial enforcement discretion, the exercise of such discretion involves a calculus completely different from that the State uses when acting in its proprietary capacity. The question is not whether a given "claim" should be exchanged for some consideration. Enforcement decisions instead turn on such factors as "the strength of the case, the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan." *Wayte v. United States*, 470 U.S. 598, 607 (1985). *See also 421 Corp. v. Metro. Gov't of Nashville*, 36 S.W.3d 469, 480 (Tenn. 2000) (recognizing in context of civil enforcement that "practical realities require the allocation of limited public resources.").

When the State released its "claims" through the Agreement, it did not surrender its entirely separate sovereign power to enact and enforce laws. Because the State must be treated as one of two private parties to the Agreement, then, absent a clear indication otherwise, the Agreement's two release provisions must be construed to have equal meaning. *See, e.g., Thompson v. Amoco Oil Co.*, 903 F.2d 1118, 1121 (7th Cir. 1990) ("Unless a contrary

intent is evident, words used in one sense in one part of a contract are deemed of like significance in another part."). Treating the State as a private party compels the conclusion that the State released no more than did Defendants – the option to pursue rights-based legal claims.

II. THE TERM "CLAIM" CANNOT BE INTERPRETED TO INCLUDE LEGISLATIVE EXACTIONS BECAUSE THE STATE'S RELEASE OF CLAIMS DOES NOT SURRENDER THE STATE'S SOVEREIGN POLICE AND TAXING POWERS "IN LANGUAGE AND TERMS TOO CLEAR TO ADMIT OF DOUBT."

A. The Unmistakability Doctrine Is A Canon Of Strict Contract Construction Rather Than A Contract Defense, And It Plainly Applies To The Facts Presented.

Defendants assert that the State invokes the unmistakability doctrine *as a defense* to its alleged breach of the Agreement. *See, e.g.*, Defs.' Br. at 31-33. As the State's principal brief makes plain, however, the unmistakability doctrine is a canon of strict construction that courts use to determine what government contracts *mean* – to determine what they actually promise. *See* State's Br. at 22-25. The doctrine is *not* a justification or excuse for a breach of promises clearly made, and is not invoked by the State for that purpose.

Defendants next assert that the doctrine does not apply here, purportedly because their construction of the Agreement does not involve the surrender of sovereign power. *See* Defs.' Br. at 16, 31, 33, 35. This is incorrect. The United States Supreme Court has explained that application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a

sovereign power of the Government." *See United States v. Winstar Corp.*, 518 U.S. 839, 879 (1996) (plurality opinion).

Invoking the Agreement, Defendants obtained a lower court Order enjoining the Commissioner from enforcing against Defendants' Distributors a valid Act of the Legislature. Defendants now ask this Court to affirm. Because Defendants assert that the Agreement bars the enforcement of a valid law, the doctrine unquestionably applies. *Id.* at 876-79 (discussing Court's own applications of doctrine); *cf. id.* at 881 (doctrine not applicable where all post-contract Congressional measures were fully enforced); *see also Gillam v. Sioux City & St. P.R. Co.*, 3 N.W. 353, 355 (Minn. 1879) (applying doctrine where railroad alleged that its charter prevented Legislature from passing law requiring railroad to build cattle fences). And, as shown in the State's principal brief, the doctrine plainly defeats Defendants' claim that the Agreement surrenders the Legislature's police or taxing powers. *See* State's Br. at 25-26.

Rather than admitting that their construction of the Agreement bars the Legislature from imposing, and the Commissioner from enforcing, the Act, Defendants attempt to reframe the issue. They thus contend that the State "assumed the risk that future legislation would . . . be unenforceable as to the Settling Defendants' products," Defs.' Br. at 33, and that "[s]uch an assumption of risk occurs whenever the State enters into a contract." *Id.* at 31. This is truly a distinction without a difference. As *Winstar* recognized, if a party contends that a contract bars the enforcement of a valid law, then that party is arguing that the contract surrenders sovereign power. *See Winstar*, 518 U.S. at 879. Tellingly, Defendants feel compelled to assert that the Agreement binds "the State *in all*

of its manifestations." *See* Defs.' Br. at 36 (emphasis added).

Defendants' assumption of risk argument stands the unmistakability doctrine on its head. Although the doctrine recognizes that the Contracts Clause limits a state's power to impair contracts through legislation, *see Winstar*, 518 U.S. at 874, it also requires that the surrender of sovereign power be stated in "unmistakable terms." *Id.* at 872. Defendants, in contrast, construe a conventional release of claims as creating a broad bar to future legislative and executive action, *see* Defs.' Br. at 15, 19-20, and they assert – without any authority – that contracts prevail over the enforcement of valid laws. *See id.* at 31, 33-34. The Court should reject this attempt to reverse the unmistakability doctrine.

B. The State Invokes The Separation Of Powers Not As A Contract Defense, But As Circumstantial Evidence That The Attorney General Did Not Surrender Legislative Authority.

As with the unmistakability doctrine, Defendants incorrectly assert that the State invokes the separation of powers *as a defense* to justify an alleged breach of the Agreement. *See* Defs.' Br. at 31, 32, 35-39. Instead, the State discusses the separation of powers because it is relevant to proper *construction* of the Agreement. *See* State's Br. at 27-30. Specifically, this constitutional principle furnishes circumstantial evidence that then-Attorney General Humphrey did not, as Defendants suggest, grant Defendants a prospective exemption from all legislative exactions on cigarettes that are used to fund state healthcare costs. *Id.* The Attorney General simply would not have entered a contract surrendering legislative authority

in direct contravention of the Minnesota Constitution. *Id.* Consequently, the Agreement should not be construed as though he did.

The parties themselves recognized that the Attorney General could not speak for the Legislature or promise legislative results. Section II.C of the Agreement provides in part that, "[t]he Attorney General will propose . . . that the Legislature appropriate to a foundation" certain listed funds. App. at 46. Although the Attorney General had the authority to bind the State "in all of its manifestations" *as to the assertion of claims*, the Agreement recognizes he could not bind the Legislature *concerning legislation*.

In addition, there is no substance to Defendants' argument that, even if the Attorney General lacked authority to surrender sovereign power, the Legislature acquiesced in the Agreement. *See* Defs.' Br. at 37-38. As an initial matter, the Legislature likely cannot acquiesce in a surrender of its powers. *See* State's Br. at 29 n.13; *Ketterer v. Indep. Sch. Dist. No. 1*, 79 N.W.2d 428, 436 (Minn. 1956) (no ratification where initial action lies outside scope of governmental body in first instance). In any event, this argument entirely begs the question. Even if evidence of acquiescence existed, Defendants could not show that the Legislature acquiesced *in their construction* of the Agreement. The State does not dispute that the Agreement is "binding and enforceable" as to the State's proprietary rights. Defs.' Br. at 38. It simply contends that Defendants misconstrue the Agreement to bind the State in its sovereign capacity.

III. In The Alternative, The Agreement Does Not Bar Imposition And Enforcement Of The HIF Because The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power.

Defendants try to finesse the tax/fee issue by repeating the claim that, under their interpretation of the Agreement, the State is not *really* surrendering its sovereign taxing power. *See* Defs.' Br. at 39. For the reasons set forth above, this claim should be rejected. *See supra* at 14.

Defendants next cite *Naftalin* for the proposition that a contract can have an "*indirect* effect" on the taxing power without violating Article X, Section 1 of the Minnesota Constitution (the "1906 Amendment"). *See* Defs.' Br. at 39 (emphasis in original) (citing *Naftalin v. King*, 90 N.W.2d 185, 191 (Minn. 1958)). *Naftalin* is inapposite, however. That case involved whether the State could contractually promise to fund bond payments, and thereby bind itself *to exercise its taxing power*. *Naftalin*, 90 N.W.2d at 190-91. This Court specifically distinguished that situation from a contract *surrendering* the taxing power, which it noted is expressly prohibited by the 1906 Amendment. *Id.* at 191. There is simply no support for Defendants' "indirect effect" argument. *See In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926) (holding that 1906 Amendment "was intended to prevent any impairment of the taxing power in any manner whatever").

The parties appear to agree, for the most part, on the standards relevant to determining whether a legislative imposition is a tax or a fee. *Compare* State's Br. at 33-36 *with* Defs.' Br. at 40. They disagree mostly on the application of those standards.

Defendants are wrong to assert that the HIF is a fee because there is a "direct relationship" between the HIF and state healthcare costs. *See* Defs.' Br. at 41-42. As an initial matter, distributors rather than smokers pay the HIF. Distributors, however, do not receive the state healthcare services the HIF allegedly funds. True fees are paid by those who receive services. *See Okeson v. City of Seattle*, 78 P.3d 1279, 1286 (Wash. 2003).

Defendants' claim fares no better even if economic burden rather than legal incidence is considered. Many people who smoke – perhaps the majority of them – will never cost the state a cent in healthcare expenditures. Many smokers, for example, have private employers and private insurers, etc. Consequently, there is no relationship at all, direct or otherwise, between the 75 cents a particular smoker pays on a pack of cigarettes and state healthcare costs.

In reality, the HIF is simply an excise tax on *all* smokers to fund the expenses that *some* smokers impose on the State. It is administered identically to the cigarette excise tax, and has no true regulatory purpose. *See* State's Br. at 38-40. The Legislature's twin expedients of including the HIF in the Ominbus Health and Human Services Bill and placing HIF proceeds into a special fund cannot convert the HIF into a fee for judicial purposes,[6] just as labeling the imposition a "fee" cannot. *See id.* at 33.

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[6] Segregating the proceeds of a tax into a special fund and earmarking them for a particular purpose do not convert a tax into a fee. *See* State's Br. at 41-42. All proceeds of Minnesota's gasoline excise tax, for example, must be placed into the Highway User Tax Distribution Fund. *See* Minn. Const. art. XIV, § 10. Those proceeds must be used "solely for highway purposes." Minn. Const. art. XIV, § 5. Nevertheless,

(Continued on following page)

CONCLUSION

For the above stated reasons, the State respectfully requests that this Court reverse the December 20, 2005 decision of the district court in its entirety.

Dated: _____

Respectfully submitted,

MIKE HATCH
Attorney General
State of Minnesota

BRADFORD S. DELAPENA
Assistant Attorney General
Atty. Reg. No. 219046

MICHAEL J. VANSELOW
Deputy Attorney General
Atty. Reg. No. 152754

445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 296-0987

ATTORNEYS FOR APPELLANT
STATE OF MINNESOTA

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this Court has held that the gasoline excise tax is a "special tax" on gasoline to fund state roadbuilding expenses. *See Amoco Corp. v. Comm'r of Revenue*, 658 N.W.2d 859, 872 & n.4 (Minn. 2003).

No. A05-2540

STATE OF MINNESOTA
IN SUPREME COURT

The State of Minnesota,
by Hubert H. Humphrey III,
its then Attorney General, *et al.*,

Petitioner,

vs.

Philip Morris USA, Inc., *et al.*,
and
A.H. Hermel Candy & Tobacco Co., *et al.*

Respondents.

STATE'S BRIEF & APPENDIX

EDWARD B. MAGARIAN, ESQ.
PETER SIPKINS, ESQ.
Dorsey & Whitney LLP
50 South Sixth Street,
Ste. 1500
Minneapolis, MN 55402-1498
(612) 340-7873

BRENT R. LINDAHL, ESQ.
SCOTT G. KNUDSON, ESQ.
Briggs and Morgan
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 977-8400

MIKE HATCH
Attorney General
State of Minnesota

BRADFORD S. DELAPENA
Assistant Attorney General
Atty. Reg. No. 219046

MICHAEL J. VANSELOW
Deputy Attorney General
Atty. Reg. No. 152754

445 Minnesota Street,
Suite 1100
St. Paul, Minnesota
55101-2128
(651) 296-0987

ATTORNEYS FOR
PETITIONER

WALTER A. PICKHARDT, ESQ.
Faegre & Benson, LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-8622

THOMAS H. BOYD, ESQ.
KARL E. ROBINSON, ESQ.
Winthrop & Weinstine, PA
Suite 3500
225 South Sixth Street
Minneapolis, MN 55402-4629
(612) 604-6400

RANDY G. GULLICKSON ESQ.
Anthony Ostlund & Baer, P.A.
90 South Seventh Street,
Suite 3600
Minneapolis, MN 55402
(612) 349-6969

ATTORNEYS FOR
RESPONDENTS

KAREN A. JANISCH, ESQ.
130 State Capitol
75 Constitution Avenue
St. Paul, MN 55155
(651) 282-3705

GOVERNOR'S GENERAL
COUNSEL

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LEGAL ISSUES

I. Does the language and context of the 1998 Settlement Agreement demonstrate that the parties intended the Agreement to provide a mutual release of adjudicatory claims only?

- The district court ruled that the Agreement surrendered legislative powers as well as adjudicatory claims.

  Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc., 666 N.W.2d 320 (Minn. 2003).

II. Did the State's release of "claims" in the Agreement surrender the Legislature's sovereign police and taxing powers "in language and terms too clear to admit of doubt"?

- The district court implicitly ruled in the affirmative.

  State v. Great N. Ry., 119 N.W. 202 (Minn. 1908).

  United States v. Winstar Corp., 518 U.S. 839 (1996).

  Minneapolis Gas Co. v. Zimmerman, 91 N.W.2d 642 (Minn. 1958).

III. Does the Agreement bar enforcement of the Health Impact Fee ("HIF") when the Agreement incorporates by operation of law the Minnesota Constitution's express prohibition against contracting away the Legislature's taxing power?

- The district court did not reach this issue.

  Minn. Const. art. X, § 1.

  Country Joe, Inc. v. City of Eagan, 560 N.W.2d 681 (Minn. 1997).

Ramaley v. City of St. Paul, 33 N.W.2d 19 (Minn. 1948).

IV. If the HIF cannot be enforced against Defendants' Distributors, does continued enforcement of the HIF against the Intervenors violate the Intervenors' equal protection rights?

- The district court ruled that continued enforcement of the HIF against Intervenors violates their equal protection rights.

Kolton v. County of Anoka, 645 N.W.2d 403 (Minn. 2002).

Lorillard Tobacco Co. v. Reilly, 533 U.S. 525 (2001).

Star Scientific, Inc. v. Beales, 278 F.3d 339 (4th Cir. 2002).

STATEMENT OF THE CASE

On May 8, 1998, the country's four largest tobacco manufacturers ("Settling Defendants" or "Defendants")[1] entered a Settlement Agreement with the State to resolve – before an empanelled jury could – the State's pending litigation. *See generally* Appendix ("App.") at 37-71 (Settlement Agreement dated May 8, 1998). On August 26, 2005, Defendants brought a motion in Ramsey County District Court to enforce that Agreement. *See* App. at 1-5[2]

[1] "Settling Defendants" include Phillip Morris USA, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company.

[2] Defendants proceeded by motion because the Consent Judgment accompanying the Settlement Agreement provides that "[j]urisdiction of

(Continued on following page)

Nine of their distributors ("Defendants' Distributors") intervened without objection. Together, Defendants and their distributors asserted that the 2005 Health Impact Fee ("HIF") – a legislatively imposed exaction on the distribution of cigarettes – is a "released claim" under the Agreement and, consequently, could not be enforced against them.

The Council of Independent Tobacco Manufacturers of America and Commonwealth Brands, Inc. ("Intervenors") separately moved to intervene. Intervenors are tobacco manufacturers and distributors that are not parties to, or beneficiaries of, the Settlement Agreement. Intervenors alleged that the HIF could not be enforced against them if the district court invalidated the HIF as to the Settling Defendants and their distributors.

The State asserted that the HIF is a valid legislative exaction not prohibited by the Settlement Agreement and, consequently, that requiring Defendants' Distributors to pay the HIF does not violate the Agreement. The State further argued that, even if the district court prohibited enforcement of the HIF against Defendants' Distributors, continued enforcement against Intervenors would not violate equal protection principles.

In an Order dated December 20, 2005, the district court, the Honorable Michael F. Fetsch presiding, held that imposing the HIF on Defendants' Distributors breached the Settlement Agreement and violated the Contracts Clauses of the state and federal constitutions. App. at 14, 16. The court then concluded that imposing the

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this case is retained [in the Ramsey Count District Court] for the purpose of enforcement. . . ." *See* App. at 80.

HIF on Intervenors alone would deprive them "of equal protection under the Uniform Taxation Clause of the Minnesota Constitution," and "would be the functional equivalent of a special legislation" favoring Defendants. *Id.* 16-18. The district court subsequently stayed enforcement of its Order pending resolution of this appeal. *See id.* at 20-21.

STATEMENT OF FACTS

A. The Minnesota Tobacco Litigation and Settlement

On August 17, 1994, the State, through then-Attorney General Hubert H. Humphrey III, commenced suit (the "State Tobacco Lawsuit") against Defendants and others. The State alleged, among other things, that Defendants, through deceit, misrepresentation and active concealment, profited from a product they knew to be deadly and addictive even as they marketed it to children. *See generally* Defs.' Mem. Supp. Mot. Enforcmnt. Settlmt. Agrmt. ("Defs.' Mem."), Affidavit of Edward B. Magarian ("Magarian Aff."), Ex. B., (State Tobacco Lawsuit, Second Amended Complaint dated Jan. 6, 1998).

The State asserted nine causes of action against Defendants, including both common law claims (e.g., unjust enrichment) and statutory claims (e.g., consumer fraud, false advertising, unlawful and deceptive trade practices and antitrust). *Id.* at 30-37. The State sought an award of substantial compensatory, punitive and treble damages, civil penalties, and equitable and injunctive relief. *Id.* at 37-40.

In May 1998, after a lengthy trial, but before the jury returned a verdict in the State Tobacco Lawsuit, the State

and Defendants entered into the Settlement Agreement and jointly obtained entry of a Consent Judgment (together, the "Agreement"). The Agreement lies at the center of the current dispute between the parties.

The parties entered the Agreement to resolve the legal claims made by Minnesota: "to settle and resolve with finality all claims . . . relating to the subject matter of this action which have been or could have been asserted by the State of Minnesota." App. at 37; *see id.* at 50-52 (State's release of claims). Defendants likewise released all of their "claims" against the State, *see id.* at 52-53, and they agreed to make specified payments in exchange for the "dismissal and release of claims by the State of Minnesota." *Id.* at 39. The term "claims" is defined in relevant part as follows:

> [T]he State of Minnesota shall release and forever discharge all Defendants and their. . . distributors . . . from any and all manner of *civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees*, known or unknown, suspected or unsuspected, accrued or unaccrued, *whether legal, equitable or statutory* ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:

> for past conduct, as to any Claims relating to the subject matter of this action . . . ; and
>
> for future conduct, only as to monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future claims for reimbursement for health care costs allegedly associated with use of or exposure to Tobacco Products.

App. at 50-51 (emphasis added).

As part of its release, the State covenanted and agreed that it would not "hereafter sue or seek to establish civil liability against any person or entity covered by the release . . . based, in whole or in part, upon any of the Released Claims." App. at 52. The State further agreed that "this covenant and agreement shall be a complete defense to any such *civil action or proceeding*." *Id.* (emphasis added).

Attorney General Humphrey was the sole elected state official to sign the Agreement. App.. at 20. The Agreement was never presented to or ratified by the Legislature.

The Settlement Agreement and an accompanying Consent Judgment were submitted by the parties to the Court, and the Honorable Kenneth J. Fitzpatrick approved and entered the Consent Judgment. *See* App. at 72-82. The Consent Judgment resolved "all claims set forth in the State's Second Amended Complaint against Defendants, which are hereby dismissed with prejudice, and shall constitute the final disposition of this action." *Id.* at 80.

B. The Minnesota Cigarette Excise Tax

When Minnesota's Settlement Agreement was negotiated and executed, the State imposed an excise tax of 48 cents per pack upon the sale of cigarettes. *See* Minn. Stat. § 297F.05, subd. 1 (Supp. 1997).[3] The State has continued to collect from distributors, without objection, the excise tax for cigarettes manufactured by the Settling Defendants.

C. The Minnesota Health Impact Fee

On July 14, 2005, Governor Pawlenty signed into law a Tobacco Health Impact Fee effective August 1, 2005. *See* Act of July 14, 2005, ch. 4, art. 4, §§ 1-6, 2005 Minn. Laws (1st Sp. Sess.) 2541-44 (the "Act") (App. at 33-36). The Act was introduced during a special legislative session and produced the political compromise that enabled Minnesota to balance its budget.[4] The Act declares that "[a] tobacco use health impact fee is imposed on and collected from cigarette distributors," and it specifies two purposes: "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by

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[3] Minnesota began taxing the sale of cigarettes in 1947. *See* Act of April 28, 1947, ch. 619, §§ 1-2, 1947 Minn. Laws 1122-24 (codified as amended at Minn. Stat. § 297.01-02 (1949)).

[4] *See, e.g.*, Bill Salisbury, *Pawlenty Battered, Unbowed at Capitol*, St. Paul Pioneer Press, July 17, 2005, at 1A ("The tobacco charge, Pawlenty said this week, is what it took to broker the deal that ended the partisan dogfight at the Capitol and pass a balanced budget that provides a big infusion of new cash for K-12 schools.").

youths." Act § 2, subd. 1. The HIF was imposed at the rate of 75 cents per pack. *Id.* § 2, subd. 3(a).[5]

The HIF is administered by the Commissioner of Revenue ("Commissioner"), who also administers the State's cigarette excise tax imposed by Minn. Stat. § 297F.05. Indeed, the Act provides that "[a] distributor must pay the fee at the same time and in the same manner as provided for payment of [the cigarette excise] tax under chapter 297F." *Id.* at § 2, subd. 4. Failure to pay either of these exactions can lead to the revocation of a distributor's license.[6] *See id.* § 2, subd. 8; Minn. Stat. § 297F.04, subd. 1 (2004).

The Act also "created in the state treasury a health impact fund to which must be credited all revenue from the health impact fee." Act § 1, subd. 1; *see also id.* § 2, subd. 9 (directing that fee revenue be credited to fund). The Act requires the Commissioner of Human Services to certify to the Commissioner of Finance each year "the state share, by fund, of tobacco use attributable costs for the previous fiscal year in Minnesota health care programs, including medical assistance, general assistance medical care, and MinnesotaCare, or other applicable expenditures." *Id.* § 1, subd. 2. The Commissioner of Finance must then transfer "to the general fund an amount sufficient to offset the general fund cost of the

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[5] The Act also imposed a floor stocks fee at the same rate to account for cigarettes already in stock or on the shelves. Act § 5, subd. 2.

[6] By selling cigarette stamps for $1.485 each, the Commissioner actually collects three charges at once: (a) the 75-cent HIF; (b) the 48-cent cigarette excise tax; and (c) the State's 25.5-cent cigarette sales tax.

certified expenditures . . . or the balance of the fund, whichever is less." *Id.* §1, subd. 3(a). If a balance remains, the Finance Commissioner must then transfer "to the health care access fund the amount sufficient to offset the health care access fund cost of the certified expenditures." *Id.* § 1, subd. 3(b).

D. Motion to Enforce Settlement Agreement

On August 26, 2005, Defendants moved to enforce the Agreement. Defendants noted that the Agreement released Defendants and their distributors from any "claims" to recover State healthcare costs attributable to tobacco use, and they asserted that the HIF qualifies as a released "claim." Defendants argued that imposing the HIF on their distributors therefore breached the Agreement and violated the Contracts Clauses of the United States and Minnesota Constitutions. Intervenors asserted that if the district court invalidated the HIF as to Defendants and their distributors, continued enforcement of the HIF against Intervenors would violate equal protection.

The State responded that the HIF is a legislative exaction rather than a released "claim" under the Agreement and, consequently, that the Agreement does not bar collection of the HIF from Defendants' Distributors. The State also argued that the Agreement incorporates the Minnesota Constitution's express prohibition against contracting away the State's taxing power, and therefore cannot bar collection of the HIF, which is in substance a tax upon the distribution and sale of cigarettes. Finally, the State argued that, even if the district court prohibited enforcement of the HIF against Defendants' Distributors,

continued enforcement against Intervenors would not violate equal protection.

By Order dated December 20, 2005, the district court enjoined the Commissioner from enforcing the HIF against both Defendants' Distributors and Intervenors. App. at 9. The court rejected the State's argument that the Agreement's release of "claims" did not apply to legislative exactions. The court reasoned that this "reading of the release, which would limit its operating effect only to 'judicial claims,' ignores definition [sic] of claims within the settlement agreement, which is much broader, and includes '. . . liabilities of any nature whatsoever' including those of a 'statutory' nature." *Id.* at 14. The court found that "[t]he H.I.F. is statutory in nature and directly imposes that from which the defendants are protected by the Settlement Agreement." *Id.* The court further concluded that the HIF is a "fee" rather than a tax, and that it violates the State's release. *Id.* at 13.

The court further determined that "defendants have proven a 'contracts clause' violation." App. at 16. "Here the state seeks to abrogate that which what [sic] it has promised but offers neither to forego future payments or to refund past payments." *Id.* The court considered it "impossible to find that the [HIF] legislation is a reasonable device which serves the end of protecting the vital interests of the community." *Id.* For these reasons, the court enjoined the Commissioner from enforcing the HIF against Defendants' Distributors.

The court next concluded that "[t]he resultant situation creates an anomoly [sic] in the marketplace by which the settling defendants' products will have a distinct marketplace advantage in price." App. at 16-17.

> In light of my decision above, the H.I.F., as applied to the distributors of nonsettling defendants, who comprise approximately ten percent of the market, will be selectively enforced only as to the remaining ten percent. None of the statute's stated statutory goals will be fulfilled. The nonsettling defendants will be singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution.

App. at 17. The court thus enjoined the Commissioner from enforcing the HIF against Intervenors. *Id.* at 9. The court subsequently stayed enforcement of its Order pending resolution of this appeal. *See id.* at 20-21.

STANDARD OF REVIEW

Because the facts in this case are undisputed, "only questions of statutory and contract interpretation remain." *Progressive Specialty Ins. Co. v. Widness ex rel. Widness*, 635 N.W.2d 516, 518 (Minn. 2001). These are legal issues subject to *de novo* review. *Id.*; *Lake Superior Paper Industries v. State*, 624 N.W.2d 254, 258 (Minn. 2001). *Cf. also Nelson v. Am. Family Ins. Group*, 651 N.W.2d 499, 503 (Minn. 2002) (holding that where district court grants summary judgment based on application of statute to undisputed facts, result is legal conclusion that appellate court reviews *de novo*). The decisional standards governing particular issues are discussed below.

SUMMARY OF ARGUMENT

This case involves an attempt by tobacco manufacturers to advance an implausible construction of an agreement settling litigation claims to block the valid exercise of the Legislature's sovereign police and taxing powers.

Imposing the HIF upon Defendants' Distributors does not violate the 1998 Settlement Agreement. The Agreement is a mutual release of adjudicatory claims only. The State promised that it would never "sue or seek to establish civil liability against any person . . . based, in whole or in part, upon any of the Released Claims." App. at 52. The language and context of the Agreement demonstrate that it does not surrender the Legislature's sovereign power to impose a tax or fee upon the distribution of cigarettes.

Moreover, even if there were some question about whether the term "claims" in the Agreement encompasses legislative exactions, any doubt over the construction of the Agreement must be resolved in the State's favor. Courts have long held that government contracts must be strictly construed against the surrender of the State's sovereign police and taxing powers. In fact, under the "unmistakability doctrine," any contractual relinquishment of these powers must be stated "in language and terms too clear to admit of doubt." For these reasons – regardless of whether it is a tax or a fee – the HIF is a legislative exaction rather than a released "claim" under the Agreement. Therefore, imposing the HIF does not breach or impair the Agreement.

In the alternative, the Minnesota Constitution provides that "[t]he power of taxation shall never be surrendered, suspended or contracted away." Minn. Const. art. X, § 1. Consequently, the Agreement could not, as a matter of

law, contract away the State's power to tax the distribution of cigarettes. Despite its label as a "fee," the HIF is really a tax on cigarette distribution. As such, the HIF is not a released "claim" and could not possibly breach or impair the Agreement.

Finally, even if the district court properly enjoined the Commissioner from enforcing the HIF against Defendants' Distributors, it erred by ruling that continued enforcement of the HIF against Intervenors violates equal protection guarantees. Equal protection is not offended when the State enforces a law of general application against all parties over whom it has lawful enforcement authority.

ARGUMENT

I. THE LANGUAGE AND CONTEXT OF THE AGREEMENT DEMONSTRATE THAT THE PARTIES INTENDED IT TO BE A MUTUAL RELEASE OF ADJUDICATORY CLAIMS ONLY.

The HIF is not a released "claim" under the Agreement. The language and context of the Agreement demonstrate that the parties drafted and executed a mutual release of adjudicatory claims only. This construction of the Agreement is further compelled by application of the well-established "unmistakability doctrine" discussed in Argument II below. Accordingly, the State's release of claims in the Agreement does not apply to, or prohibit, future legislative exactions such as the HIF. Because the

district court erred in its cursory analysis of this issue, this Court should reverse.[7]

A. The Settlement Agreement And Consent Judgment Must Be Construed As A Contract.

Consent judgments are entered into by parties after careful negotiations concerning precise terms, and must be "construed for enforcement purposes basically as a contract." *United States v. ITT Cont'l Baking Co.*, 420 U.S. 223, 238 (1975). Accordingly, the Agreement must be interpreted to "give effect to the mutual intention of the parties at the time of contracting." *Carl Bolander & Sons, Inc. v. United Stockyards Corp.*, 215 N.W.2d 473, 476 (Minn. 1974) (internal quotation marks and citation omitted). "[T]he scope of a consent decree must be discerned within its four corners." *United States v. Armour Co.*, 402 U.S. 673, 681 (1971).

The Court's duty is "to declare the meaning of what is written in the instrument." *Carl Bolander & Sons*, 215 N.W.2d at 476. To arrive at that meaning, courts must construe contract terms in the context of the entire document, reading together and harmonizing terms where possible. *See Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc.*, 666 N.W.2d 320, 324 (Minn. 2003) ("Intent is ascertained . . . from a process of synthesis in which the words and phrases are given a meaning in accordance

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[7] The Court need not reach the issues addressed in Arguments II, III and IV below if it rules, based on the language and context of the Agreement, that the State's release of "claims" did not surrender legislative authority.

with the obvious purpose of the contract . . . as a whole."). "Where the parties express their intent in unambiguous words, those words are to be given their plain and ordinary meaning." *Id.* at 323.

B. The Language And Context Of The Agreement Demonstrate That The Parties Intended To Release Only Adjudicatory Claims.

The familiar principles of construction set forth above make clear that the "claims" released by Minnesota did not encompass future legislative enactments of taxes or fees, but instead were limited to adjudicatory claims.

1. The Purpose of the Agreement was to Resolve Particular Adjudicatory Claims.

The purpose of the Agreement was to resolve the particular legal claims made by Minnesota in its underlying lawsuit. The Settlement Agreement states, for example, that it "resolve[s] with finality all *claims . . . relating to the subject matter of this action* which have been or could have been asserted by the State of Minnesota." App. at 37 (emphasis added).[8] Defendants agreed to make specified payments in exchange for the "dismissal and release of *claims* by the State of Minnesota." *Id.* at 39 (emphasis added). The Consent Judgment likewise recites that it "resolves all *claims* set forth in the State's Second

[8] *See also* App. at 50 (stating that Settlement Agreement "resolves all *claims* between State and Defendants" and that upon approval by Court, final judgment shall enter "dismissing with prejudice all *claims* as to all Defendants") (emphasis added).

Amended Complaint . . . and shall constitute the final disposition of this action." *Id.* at 80 (emphasis added). The purpose of the Settlement Agreement and Consent Judgment – resolving an active lawsuit involving specific pending legal claims – demonstrates that the released "claims" were likewise legal claims.

2. The Parties' Definition of "Claims" Refers to Adjudicatory Claims.

The parties' definition of "claims" clearly refers to adjudicatory claims. The Agreement defines "claims" in the State's release as "any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ('Claims'). . . ." App. at 50-51. By means of almost identical language contained in a separate provision, Defendants released their "claims" against the State. *See id.* at 52-53. The Agreement is thus, in part, a mutual release of claims.

The adjudicatory context is apparent when the language of the Agreement's release provisions is read to harmonize rather than fragment their words and phrases. The term "claims" used in both provisions captures three general categories. The opening group of terms in the definition – "civil claims, demands, actions, suits and causes of action" – are all variants of adjudicatory proceedings and the causes of action asserted therein. The next group – "damages whenever incurred, liabilities of any nature whatsoever, including civil penalties" – and expenses

that can result from the adjudication of claims. The final group – "costs, expenses and attorneys' fees" – are expenses associated with pursuing judicial claims. In drafting their settlement agreement, the parties used the term "claims" in its ordinary sense, to refer to lawsuits and the liabilities and costs incident to such suits, whether the basis of the suits was "legal, equitable or statutory."

This typical meaning is confirmed by the covenant in the State's release, which refers exclusively to the adjudicatory context:

> The State of Minnesota hereby covenants and agrees that it shall not hereafter *sue or seek to establish civil liability* against any person or entity covered by the release . . . based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be a complete defense *to any such civil action or proceeding*.

App. at 52 (emphasis added). The parties did not, as Defendants assert, use the term "claims" in a strained and unnatural way, to encompass legislative acts.[9]

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[9] The terms "claim" and "cause of action" are virtually synonymous and both pertain to the adjudicatory context. *Black's Law Dictionary*, for example, defines "claim" in relevant part as follows:

> 1. The aggregate of operative facts giving rise to a right enforceable by a court. . . . 2. The assertion of an existing right; any right to payment or to an equitable remedy, even if contingent or provisional. . . . 3. A demand for money, property, or a legal remedy to which one asserts a right; esp., the part of a complaint in a civil action specifying what relief the plaintiff asks for. . . . 4. An interest or remedy recognized at law; the means by which a person can obtain a privilege, possession or enjoyment of a right or thing; cause of action. . . .

(Continued on following page)

3. When the Parties Referred to Future Legislative Action in the Agreement, They Expressly Used the Term "Legislation."

Defendants are highly sophisticated entities that have for decades been subject to a myriad of state and federal legislative regulation and taxation. Had the parties actually intended the State's release to surrender the Minnesota Legislature's sovereign authority to impose either a regulatory fee or a tax upon the distribution of cigarettes, they would have used suitable language to indicate this intention. Indeed, the parties consistently used the word "legislation" in the Agreement to identify future action by either Congress or the Minnesota Legislature, and they referred to these legislative assemblies by name. The parties specified, for example:

- How "[t]he enactment of federal tobacco-related *legislation*" will affect the Agreement. *See generally* App. at 48.
- That Defendants shall not "[s]upport in *Congress* or any forum, *legislation*, rules or policies which would preempt, override, or abrogate or diminish the State's rights or recoveries under this Agreement." *Id.* at 54.
- That Defendants shall not "[o]ppose the passage of those *future Minnesota legislative proposals* or administrative rules intended by their terms to

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Black's Law Dictionary 264 (8th ed. 2004). *See also Hauschildt v. Beckingham*, 686 N.W.2d 829, 840 (Minn. 2004) (stating that "claim" and "cause of action" "can be used interchangeably"); *Martin ex rel. Hoff v. City of Rochester*, 642 N.W.2d 1, 9 (Minn. 2002) (stating that a claim or cause of action is "a group of operative facts giving rise to one or more bases for suing").

reduce tobacco use by children listed on Schedule B. (The foregoing does not prohibit Settling Defendants from resisting enforcement of, or suing for declaratory or injunctive relief with respect to any such *legislation* or rule on any grounds.)" *Id.*

- That "the parties recognize that *Congress* is considering *national tobacco legislation* and have agreed to settle this case on a basis which acknowledges *possible federal legislation*, but which guarantees to the people of Minnesota the relief granted herein." *Id.* at 69.

Had the parties intended a surrender of State legislative powers in addition to the legal claims identified in the State's release, they would have made their intention plain by using the term "legislation" as they frequently did elsewhere in the Agreement. The terms "claims" and "legislation" are distinct, have different meanings, and cannot be used interchangeably. *See, e.g.*, *Winthrop Res. Corp. v. Stanley Works*, 259 F.3d 901, 905 (8th Cir. 2001) (refusing to equate two separate contract terms and holding that distinct terms have separate meanings); *Sultan Chemists, Inc. v. EPA*, 281 F.3d 73, 79-80 (3d Cir. 2002) (same).

C. The District Court Improperly Expanded The State's Release By Ruling That It Applied To – And Prohibited – Legislative Enactments.

The district court reasoned that the State's release encompasses legislative impositions merely because it includes the phrase: "liabilities of any nature whatsoever." App. at 14. This ruling is incorrect for several reasons. First, some broad mention of "all liabilities" is boilerplate

language routinely used in release-of-claims provisions resolving adjudicatory disputes. *See, e.g., Minnesota Def. Lawyers Ass'n Release Deskbook*, App. of Forms at F-1 (Eric J. Magnuson & Stephen O. Plunkett eds. 1998). For example, the model version of a "Full and Final Release of All Claims" states:

> IN CONSIDERATION of the payment of . . . , I/we do hereby release and forever discharge [DEFENDANT] . . . from *any and all liability*, actions, causes of action, claims and demands, known and unknown, upon and by reason of any damage, loss or injury which heretofore have been or which hereafter may be sustained by me. . . .

Id. (emphasis added). In the settlement context, "liability" is a subset of judicial "claims."[10] It is unreasonable to attribute a broader meaning to that term here simply because one of the parties is a government entity. Indeed, nothing indicates that the term "liabilities" in this *particular* release was intended to encompass future state legislative enactments. Rather, the only reasonable conclusion is that the parties used boilerplate – customary language – for its customary purpose. If this Court were to adopt the

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[10] *See id.* at F-11 ("The term 'claims or causes of action' includes, but is not limited to, *all liability*, actions, causes of action, claims and demands. . . .") (emphasis added); F-48 ("Employee hereby . . . releases . . . Company from any and all federal, state or local charges, claims, controversies, causes of action, damages, costs, attorneys' fees, *or liabilities of any nature. . . .*") (emphasis added); and F-65 ("ABC Corporation . . . and the Settling Defendants . . . do hereby release . . . each other . . . from and for any and all existing or potential demands, causes of action, equitable or legal claims, obligations, damages, losses, penalties *and liabilities of any nature whatsoever. . . .*") (emphasis added).

district court's reasoning, every State settlement agreement that includes a boilerplate release referring to "all liabilities" would actually work a broad surrender of legislative power. This result is both unreasonable and contrary to well established precedent. *See infra*, Arg. § II (discussing unmistakability doctrine).

Second, the phrase "liabilities of any nature whatsoever" appears in the Defendants' release as well as the State's. *See* App. at 52-53. Plainly, however, Defendants had no legislative authority to surrender. Courts disfavor reading the same term to mean different things in different parts of a contract. *See, e.g., Thompson v. Amoco Oil Co.*, 903 F.2d 1118, 1121 (7th Cir. 1990) ("Unless a contrary intent is evident, words used in one sense in one part of a contract are deemed of like significance in another part.").

Third, the district court erred by concluding that the HIF is a released "statutory claim" under the Agreement. *See* App. at 14. Both release provisions in the Agreement – the State's and the Defendants' – surrender claims "whether legal, equitable, or statutory." The term "statutory claims" refers to legal causes of action provided by statute rather than common law. The State, for example, asserted several "statutory claims" in the State Tobacco Lawsuit, including consumer fraud, false advertising and antitrust. *See* Defs.' Mem., Magarian Aff., Ex. B. at 31-36. Nothing in the context or language of the Agreement suggests that "statutory claims" encompasses future legislative enactments of self-executing fees or taxes, particularly where this same meaning cannot be applied to the same language in Defendants' release.

In negotiating the Agreement, the parties used common and well defined legal terms. When interpreting the

Agreement, the Court should give such terms their common meaning and find that "claims" refers exclusively to adjudicatory claims or causes of action that Minnesota agreed never again to pursue. The Court should not broaden these terms to cover future legislative acts.

D. Because The Agreement Does Not Surrender The Legislature's Power To Impose An Exaction On The Distribution Of Cigarettes, Imposing The HIF Does Not Breach Or Impair The Agreement.

The district court ruled that imposing the HIF on Defendants' Distributors breaches and impairs the Agreement. App. at 14, 16. Because the State did not convey away its sovereign authority to impose legislative exactions upon the distribution of cigarettes, these legal conclusions were erroneous.

Breach of contract occurs when a party totally or partially fails to perform its obligations under a contract. *See, e.g., Associated Cinemas of Am. v. World Amusement Co.*, 276 N.W. 7, 10 (Minn. 1937). Impairment of contract in violation of the federal and state contracts clauses[11] occurs when a state law substantially disrupts a party's reasonable contractual expectations. *Jacobsen v. Anheuser-Busch, Inc.*, 392 N.W.2d 868, 872 (Minn. 1986). Impairment occurs, that is, where legislation "alters the terms of a contract by effectively imposing on one of the parties an obligation which it had not reasonably

[11] U.S. Const. art. I, § 10 states: "No state shall . . . pass any . . . law impairing the obligation of Contracts." Minn. Const. art. I, § 11 states: "No . . . law impairing the obligation of contracts shall be passed."

anticipated or relieving a party of a contractual obligation." *Bannum, Inc. v. Town of Ashland*, 922 F.2d 197, 202 (4th Cir. 1990) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-46 & n.16 (1978)).

The district court ruled that enforcing the HIF against Defendants' Distributors breaches the Agreement because it "directly imposes that from which the defendants are protected." App. at 14. The court likewise found impairment of the Agreement concluding that "the state seeks to abrogate that which what [sic] it has promised but offers neither to forego future payments or to refund past payments." *Id.* at 16. This, however, is just another way of saying that imposition of the HIF breaches the State's release.

As discussed above, imposition of the HIF does not breach the Agreement. Consequently, it also does not impair the Agreement. Although the State promised it would never again sue Defendants to recover State healthcare costs, it never promised Defendants that their products would be immune to future legislative impositions.

II. THE TERM "CLAIM" CANNOT BE INTERPRETED TO INCLUDE LEGISLATIVE EXACTIONS BECAUSE THE STATE'S RELEASE OF CLAIMS DOES NOT SURRENDER THE STATE'S SOVEREIGN POLICE AND TAXING POWERS "IN LANGUAGE AND TERMS TOO CLEAR TO ADMIT OF DOUBT."

Even if there were some question about whether the term "claims" encompasses legislative exactions like the HIF, any doubt must be resolved in the State's favor. As a sovereign, the State possesses both the police and taxing powers. Courts have long disfavored construing government

contracts as relinquishing a state's sovereign powers. Courts thus hold that any such relinquishment must be stated "in language and terms too clear to admit of doubt." *State v. Great N. Ry.*, 119 N.W. 202, 205 (Minn. 1909), *aff'd*, *Great N. Ry. v. State*, 216 U.S. 206 (1910). The district court erred by failing to apply this well-established principle when construing the Agreement.

A. The Unmistakability Doctrine Requires That Government Contracts Be Strictly Construed Against The Surrender of Sovereign Powers.

The canon of construction requiring that government contracts be strictly construed against the relinquishment of sovereign powers is known as the "unmistakability doctrine." As formulated by the United States Supreme Court, "sovereign power . . . governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." *United States v. Winstar Corp.*, 518 U.S. 839, 872 (1996) (plurality opinion) (ellipsis in original) (internal quotation marks omitted) (quoting *Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52 (1986)). The doctrine recognizes that the sovereign power of a state can be limited by the Contracts Clause of the United States Constitution, but that any such limitation is potentially problematic. *Id.* at 873-74. "Although [the Contracts] Clause made it possible *for state legislatures* to bind their successors by entering into contracts, it soon became apparent that such contracts could become a threat to the sovereign responsibilities of state governments." *Id.* at 874 (emphasis added).

The unmistakability doctrine was developed by courts "to protect state regulatory powers." *Id.* As explained in *Winstar*:

> Under this rule that all public grants are strictly construed, we have insisted that nothing can be taken against the State by presumption or inference, and that neither the right of taxation, nor any other power of sovereignty, will be held . . . to have been surrendered, unless such surrender has been expressed in terms too plain to be mistaken.

Id. at 874-75 (ellipsis in original) (internal quotation marks and citations omitted). In addition to stating the doctrine's affirmative requirements, *Winstar* also described its negative implications:

> a contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act (including an Act of Congress), nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power.

Id. at 878. The Court explained that application of the doctrine "turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government." *Id.* at 879.

This Court has likewise applied the unmistakability doctrine to resist construing contracts as abrogating the State's sovereign power. Before an amendment to the Minnesota Constitution in 1906, for example, it was settled law that the State "may, by contract, irrevocably bind itself not to exercise, or may irrevocably limit the exercise of, its power of taxation." *State ex rel. Hahn v.*

Young, 9 N.W. 737, 747 (Minn. 1881). Despite the State's clear *authority* to abrogate its own power of taxation, the Court nevertheless resisted finding that this authority had been exercised.

> The right of a state government . . . by contract to limit its power of taxation, is a doctrine too firmly established to admit of discussion at this time . . . The contract to be irrepealable, however, must clearly and conclusively appear. The power of taxation is a sovereign prerogative; its exercise is indispensable to the maintenance of the state and its institutions, and no inferences or presumptions arising from indefinite and uncertain language that it has relinquished, limited, or abandoned the right as to any particular person or corporation should be indulged by the court in support of an immunity not enjoyed by all taxpayers alike. *Therefore the contract is strictly to be construed, and must be in language and terms too clear to admit of doubt.*

Great N. Ry., 119 N.W. at 205 (emphasis added). Thus, even when the Minnesota Constitution *permitted* surrender of the taxing power, this Court resisted construing contracts to effect that purpose. All ambiguity was resolved in favor of reserving the State's sovereign power. *Id.; see also Minneapolis Gas Co. v. Zimmerman*, 91 N.W.2d 642, 656 (Minn. 1958) ("[A]ll contracts made by the state are entered into subject to the implied condition that they are ever subordinate to a reasonable and proper exercise of the state's inalienable police power.").

B. The Agreement Does Not Surrender The Legislature's Police And Taxing Powers "In Language And Terms Too Clear To Admit Of Doubt."

The unmistakability doctrine defeats Defendants' claim that the Agreement surrenders the State's police and taxing powers and bars enforcement of the HIF. For such a bar plainly "would block the exercise of a sovereign power of the [State]." *Winstar*, 518 U.S. at 879. First, it would abridge the Legislature's power to impose a fee or tax on the distribution of cigarettes by limiting the exaction to only some cigarettes. Second, as the district court's Order makes clear, it would prevent the Commissioner from enforcing existing law. The doctrine was developed to avoid precisely such results.[12]

The district court's construction of the Agreement does not satisfy the strict requirements of the unmistakability doctrine. The State's release-of-claims provision does not even *mention* the State's taxing or police powers. *Cf. Winstar*, 518 U.S. at 877-78 (waiver of sovereign power will not be inferred from silence). Moreover, that provision contains no language even equivocally suggesting that the State was – in addition to releasing legal claims – surrendering sovereign authority. Even if the State's release were

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[12] The district court did not apply the unmistakability doctrine to *construe* the State's release – to determine its scope in the first instance. Instead, the court interpreted the release as surrendering sovereign powers *without applying the doctrine*, and then declared that this surrender was unproblematic because "the State has consented to the Settlement Agreement. . . ." *See* App. at 16. This, of course, entirely misses the point. For if the Agreement is properly construed under the doctrine as *not* surrendering sovereign powers, then there is no surrender to which the State could "consent."

ambiguous on this point, it would have to be construed as reserving to the State its sovereign powers. *Id.* at 878 ("nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power"); *Great N. Ry.*, 119 N.W. at 205 (prohibiting "inferences or presumptions" of surrender "arising from indefinite and uncertain language"). Most importantly, the Agreement does not declare that the State is surrendering its police or taxing authority "in language and terms too clear to admit of doubt." *Great N. Ry.*, 119 N.W. at 205; *Winstar*, 518 U.S. at 874-75 (requiring unmistakable clarity).

C. The Construction Required By The Unmistakability Doctrine Is Confirmed By The Parties' Drafting Practice.

In this case, the parties' drafting practice confirms the wisdom of the unmistakability doctrine. When the State surrendered a right *not also relinquished by Defendants*, the parties clearly indicated this difference. Although the Agreement's two release provisions are almost identical, the State's release contains *an additional phrase* releasing Defendants from "civil penalties." *Compare* App. at 14 *with id.* at 16. This difference make sense: having no authority to impose civil penalties, Defendants had no occasion to release the State from such penalties. The additional phrase demonstrates that the parties used unambiguous language to signal when the State was surrendering additional "claims."

Cigarette manufacturers do not possess sovereign police and taxing powers; the State does. Whereas Defendants could have no occasion to surrender such powers, the State could. Yet the State's release contains no extra

language surrendering its sovereign powers. The absence of additional, unambiguous language confirms that the Agreement does not surrender the State's sovereign powers.

D. The Construction Required By The Unmistakability Doctrine Is Also Required By The Constitutional Separation Of Powers, Under Which The Term "Claim" Cannot Be Interpreted To Include Legislative Exactions.

Like any contract, the Agreement "must be deemed to have been executed with reference to settled rules of law governing the subject matter." *Despatch Oven Co. v. Rauenhorst*, 40 N.W.2d 73, 78 (Minn. 1949). The Minnesota Constitution provides: "The powers of government shall be divided into three distinct departments: legislative, executive and judicial. No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others . . . ." Minn. Const. art. III, § 1. Attorney General Humphrey would not have violated the Minnesota Constitution and acted *ultra vires* by executing an agreement that surrendered Legislative powers. It is unreasonable to interpret the State's release of "claims" as working such a surrender.

The Attorney General is an officer of the Executive Department. Minn. Const. art. V, § 1. As relevant here, the Attorney General controls state litigation. *See* Minn. Stat. §§ 8.01, 8.31, 8.32; *Slezak v. Ousdigian*, 110 N.W.2d 1, 5 (Minn. 1961) (finding that Attorney General's powers include "extensive common law powers" as well as statutory powers, and noting that "courts will not control the discretionary power of the attorney general in conducting

litigation for the state"); *State ex rel. Schmidt v. Youngquist*, 227 N.W. 891, 892 (Minn. 1929) (declaring that the Attorney General "has charge of the state's litigation and is its legal leader and advisor").

Attorney General Humphrey commenced and controlled the lawsuit against Defendants and entered into the Agreement. As Attorney General, he also had the power to file – or to agree to refrain from filing – *future* lawsuits against the Defendants. *See Slezak*, 110 N.W.2d at 5. Consequently, Attorney General Humphrey had both the prerogative to enter a release of *legal claims* and the authority to ensure its performance.

In contrast, the Attorney General possessed no measure of legislative authority. *See* Minn. Const. art. III, § 1. He did not have authority to promise that the Legislature would refrain from exercising the State's police powers, which this Court has declared "inalienable." *See Zimmerman*, 91 N.W.2d at 656. Nor did he have authority to contract away the Legislature's power to tax. *See* Minn. Const. art. X, § 1; *In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926). It is unreasonable to conclude that the Attorney General in executing the Agreement, and the district court in ratifying it, acted *ultra vires* and flouted these postulates of Minnesota law.

The only meaningful promise the Attorney General could make, beside settling the State Tobacco Lawsuit and compromising monetarily, was to agree never again to sue Defendants for any legal claims relating to the subject matter of that litigation. By construing the State's release of "claims" to bar only future suits or attempts to establish civil liability through litigation, the Court enforces the important constitutional separation of powers, protects

proper Legislative prerogative, and gives the Agreement its most natural and rational interpretation.[13]

The unmistakability doctrine and the separation of powers both confirm that the parties executed a release of adjudicatory claims only, and that imposing the HIF on Defendants' Distributors does not breach or impair the Agreement. *See supra*, Arg. § I.D.

III. In The Alternative, The Agreement Does Not Bar Imposition And Enforcement Of The HIF Because The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power.

The Agreement releases Defendants and their distributors from specified state "claims." It neither surrenders – nor purports to surrender – the State's power to tax the distribution of cigarettes. To the contrary, the Agreement must be interpreted as expressly reserving the State's taxing power. This is an *addition* reason to conclude that the Agreement did not surrender the state's taxing power in particular.

The district court erroneously ruled that the HIF is a "fee." *See* App. at 13-14. The court specifically noted,

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[13] The district court finessed the separation-of-powers issue by declaring that the Legislature "acquiesced" in the Agreement. *See* App. at 7 & n.1, 10, 11. This conclusion unrealistically assumes that the Attorney General acted *ultra vires* and violated the Minnesota Constitution. It also fails to explain how the Legislature could "acquiesce" in the surrender of its "inalienable" police powers. *Cf. Springer v. Philippine Islands*, 277 U.S. 189, 208-09 (1928) (doubting that the theory of legislative acquiescence applies "to matters which go to the power of the Legislature to enact" statutes).

however, that "the Legislature is free to raise revenue by means of a tax, and all parties agree that there would be no basis to override such a tax." *Id.* at 15. Proper analysis reveals that, in substance, the HIF is a tax on the distribution of cigarettes. Because a tax is not a released "claim," the Agreement does not bar enforcement of the HIF.

A. The Agreement Incorporates The Minnesota Constitution's Express Prohibition Against Contracting Away The Taxing Power And Does Not Surrender That Power.

The Minnesota Constitution provides that "[t]he power of taxation shall never be surrendered, suspended or contracted away." Minn. Const. art. X, § 1. This prohibition was added to the Constitution by amendment in 1906 ("1906 Amendment").[14] *See* Act of Dec. 27, 1906, 1907 Minn. Laws ix; *In re Minnehaha Parkway*, 209 N.W. 939, 940 (Minn. 1926). The "broad, all-comprehensive language" of the 1906 Amendment "leaves no doubt that it was intended to prevent any impairment of the taxing power in any manner whatever." *Minnehaha Parkway*, 209 N.W. at 940. Governing rules of contract construction require the Court to read the 1906 Amendment into the Agreement.

Contracting parties are presumed to know of laws that directly affect their rights. *See Albrecht v. Sell*, 110

[14] Before this amendment, the State could, by contract, limit its power to tax. *See, e.g., State ex rel Hahn v. Young*, 9 N.W. 737, 746 (Minn. 1881).

N.W.2d 895, 897 (Minn. 1961). Moreover, they are generally presumed to enter contracts "with reference to the existing rules and principles of law applicable to the subject matter." *Propp v. Johnson*, 300 N.W. 615, 617 (Minn. 1941).

> [T]he rationale for this basic rule is that the parties to the contract would have expressed that which the law expressly provides had they not supposed that it was unnecessary to do so. Thus, the court in construing the existing law as a part of the express contract, is not reading into it provisions which are different from those expressed and intended by the parties; it is merely construing the contract in accordance with their intent.

Globe v. Cent. Sec. Mut. Ins. Co., 260 N.E.2d 860, 862 (Ill. Ct. App. 1970); *see also Denice v. Spotswood I. Quinby, Inc.*, 237 A.2d 4, 7 (Md. 1968). This rationale is particularly appropriate where the State is a contracting party.

Under this rule of construction (the "Existing Law Rule"), "[t]he existing statutes and the settled law of the land at the time a contract is made become part of it and must be read into it except where the contract discloses an intention to depart therefrom." *William Lindeke Land Co. v. Kalman*, 252 N.W. 650, 653 (Minn. 1934). "It is well established that to know the obligations of a contract, [a court] must look to the laws in force at the time of its making." *W. States Util. Co. v. City of Waseca*, 65 N.W.2d 255, 261 (Minn. 1954). This rule applies to constitutional provisions. *See Dennis*, 237 A.2d at 7.[15]

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[15] *See also Sch. Dist. No. One of Pima County v. Hastings*, 472 P.2d 44, 46 (Az. 1970) ("the Constitution and laws of the State are a part of

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Because the 1906 Amendment was in force when the Agreement was executed, the Existing Law Rule requires that the Agreement be read as expressly containing: (a) an enumeration of released "claims," *and* (b) a provision specifying that the State's power of taxation "shall never be surrendered, suspended or contracted away." *See, e.g.*, *Propp*, 300 N.W. at 617 (reading existing trust law into contract for deed). These provisions must then be harmonized "to unite them into a consistent agreement." *Eveleth Taconite Co. v. Minnesota Power & Light Co.*, 221 N.W.2d 157, 160 (Minn. 1974) (citation omitted). When the Agreement is read as a whole to include the 1906 Amendment, it must be construed as reserving to the State its absolute power to tax cigarettes.

The Minnesota Court of Appeals has employed precisely this reasoning. In *Anderson v. State*, 435 N.W.2d 74 (Minn. Ct. App. 1989), plaintiffs alleged that the State was contractually bound to continue providing a statutory tax break that was in force when plaintiffs entered certain contracts to which the State was a party. *Id.* at 75-76. The court acknowledged that plaintiffs "may have known of the existence" of the tax break when they executed the contracts, but concluded that this knowledge did not "create a private contractual right" to continue receiving the tax break. *Id.* at 76-77. This was so because the Existing Law Rule included constitutional as well as statutory provisions:

> Increasing taxation or adding a new tax does not impair the obligation of a contract. It is true that

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every contract"); *Globe*, 260 N.E.2d at 862-63 (Existing Law Rule incorporates into contracts "the constitution, statutes, codes, ordinances and court decisions").

> the [statutory] law, as it existed at the time the contract was made, is a part of the contract, *but so is the law with reference to the state's power of taxation.*

Id. at 77 (emphasis added) (quoting *Wiseman v. Gilloiz*, 96 S.W.2d 459, 463 (Ark. 1936)). The Existing Law Rule incorporates the 1906 Amendment into the Agreement and shows that the Agreement did not contract away the State's power to tax.

B. The HIF Is A Tax Rather Than A Fee Because Its Express Purpose Is To Raise Revenue And Because That Revenue Is Ultimately Transferred To The General Fund To Finance Customary Governmental Functions.

The HIF was labeled a fee rather than a tax in the political realm (though not without dissent).[16] This Court has made clear, however, that the legal character of an exaction turns not on its label, but on its purpose and effect. *See Country Joe, Inc. v. City of Eagan*, 560 N.W.2d 681, 686 (Minn. 1997); *Farmers Ins. Group v. Comm'r of Taxation*, 153 N.W.2d 236, 240 (Minn. 1967). Although there is no bright-line test for differentiating between fees and taxes, well-established judicial standards demonstrate that the HIF is a tax.

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[16] *See, e.g.*, Dan Browning, *The Budget Deal*, Minneapolis Star Tribune, July 13, 2005, at 1A (reporting that Rep. Phil Krinkie, Chairman of the House Taxes Committee, resigned as Chairman of the House Working Group on Taxes "because he disagreed with Pawlenty and the House leadership over their support for the tobacco fee, which he insists should be called a tax").

1. The Purpose And Effect Of An Exaction Determine Whether It Is A Tax Or A Fee.

A fee is imposed under the police power, and is "a charge upon those engaged in [a business] for the support and maintenance of the machinery provided by statute for its regulation." *State v. Hovorka*, 110 N.W. 870, 872 (Minn. 1907). Accordingly, "a license fee may be of sufficient amount to include the expense of issuing the license and the cost of the necessary police surveillance connected with the business or calling licensed." *Village of Minneota v. Martin*, 145 N.W. 383, 384 (Minn. 1914). In addition, the nature of a business "may justify, purely from a police power standpoint, a license fee large enough to operate as a restraint upon the number of persons who might otherwise engage therein." *Ramaley v. City of St. Paul*, 33 N.W.2d 19, 22 (Minn. 1948).

A tax, by contrast, is imposed under the taxing power as a revenue-generating measure. *Country Joe, Inc.*, 560 N.W.2d at 686 (holding that city "charge" was tax because it was a revenue-raising measure); *Farmers Ins. Group*, 153 N.W.2d at 240 ("If revenue is the primary purpose, the imposition is a tax.").[17]

"It is not possible to come up with a single test that will correctly distinguish a tax from a fee in all situations. . . ." *State ex rel. Petrol. Underground Storage Tank Release Comp. Bd. v. Withrow*, 579 N.E.2d 705, 710 (Ohio 1991); *see also Okeson v. City of Seattle*, 78 P.3d 1279, 1285

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[17] *Accord River Falls v. St. Bridget's Catholic Church of River Falls*, 513 N.W.2d 673, 675 (Wis. Ct. App. 1994) ("primary purpose of a tax is to obtain revenue"); *Radio Common Carriers v. State*, 601 N.Y.S.2d 513, 515 (N.Y. Sup. Ct. 1993) (tax is "a levy made for the purpose of raising revenue for a general governmental purpose.").

(Wash. 2003) ("Determining what is a tax or a fee is often quite difficult."). Courts look to the substance of challenged legislative exactions rather than to labels, and try to determine their genuine purpose and effect. *See Ramaley*, 33 N.W.2d at 21 (revenue-raising purpose rendered charge a tax); *Farmers Ins. Group*, 153 N.W.2d at 240 (regulatory purpose rendered charge a fee); *Barron v. City of Minneapolis*, 4 N.W.2d 622, 624 (Minn. 1942) (invalidating license fee after concluding that "[w]hat the city council sought to accomplish, and did accomplish, was the enactment of a revenue measure").[18] "Whether a particular statute is a tax or regulatory licensing statute under the police power can be determined from looking at the whole scope and provisions of the enactment." *People v. Bd. of Managers – New City Condo.*, 474 N.Y.S.2d 376, 381 (N.Y. Sup. Ct. 1984).

When an exaction occupies the middle ground between a tax and a fee, courts tend to "emphasize the revenue's ultimate use, asking whether it provides a general benefit to the public, of a sort often financed by a general tax, or whether it provides more narrow benefits to regulated companies or defrays the agency's costs of regulation." *San Juan Cellular Tele. Co. v. Pub. Serv. Comm'n*, 967 F.2d 683, 685 (1st Cir. 1992); *accord Country Joe, Inc.*, 560 N.W.2d at 686.

This substance-over-labels approach was used in *Ramaley v. City of St. Paul*, 33 N.W.2d 19 (Minn. 1948), in which plaintiff liquor dealers alleged that a local $750

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[18] *Accord President Riverboat Casino-Missouri v. Missouri Gaming Comm'n*, 13 S.W.3d 635, 638 (Mo. 2000) ("[W]hat is labeled a fee may in fact be a tax based on its 'real object, purpose and result.' ").

occupation tax was really just a fee that exceeded a State-imposed $250 limit. *Id.* at 20. This Court noted that the tax ordinance "by its express words purports to impose a tax" and that "[i]ts language indicates a revenue purpose." *Id.* at 21. Moving to substance, the Court found no indication that the ordinance was an "exercise of the police power for the licensing or regulation of the liquor business," *id.*, and noted the following in particular:

- The ordinance "establishes no standards of conduct or character for those engaged" in the liquor business.
- Payment "confers no right or privilege to engage in the liquor traffic, and it neither enlarges nor changes any privilege already possessed."
- Payment "is not a condition precedent to the right to do business."
- Failure to pay "unlike a failure to pay a license fee imposed under the police power, does not make it unlawful to continue in the business. The only consequence of nonpayment is a ten percent penalty."

Id. (citation omitted). The ordinance truly imposed a tax where "the privilege or right to operate could be acquired only by payment of a license fee under an entirely different ordinance." *Id. See also President Riverboat Casino*, 13 S.W.3d at 638 (per-patron "admission fee" paid by casino boats was tax rather than fee where its receipts did not "compensate public officials for particular services" but instead funded "customary governmental expenditures").

2. The HIF Is A Tax Because Its Primary Purpose Is To Raise Revenue To Fund Core Governmental Functions.

A proper focus on substance, as illustrated by *Ramaley*, demonstrates that the HIF is a tax rather than a fee. Although the Act purports to impose a fee, "its language indicates a revenue purpose." *See Ramaley*, 33 N.W.2d at 21. First, the Act's expressly stated purpose is to raise revenue: "to recover for the state health costs related to or caused by tobacco use and to reduce tobacco use, particularly by youths." Act § 2, subd. 1. Indeed, the HIF is expected to generate approximately $400 million over the next two fiscal years,[19] enough to warrant the creation in the treasury of a special fund. *See* Act § 1, subd. 1 (creating Health Impact Fund). In fact, at 75 cents per pack, the HIF will generate substantially more revenue than the State's 48-cent per-pack cigarette excise tax. *See* Minn. Stat. § 297F.05, subd. 1.

Second, HIF revenue is transferred each year from the Health Impact Fund to the General Fund to cover *already-existing* state healthcare commitments related to tobacco use. *See* Act § 1, subd. 3(a); *see also id.* subd. 3(b) (providing that any residual in Health Impact Fund must be transferred to State healthcare access fund). Healthcare expenditures by the Department of Human Services constitute over twenty percent of the State's annual

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[19] *See* Minnesota House of Representatives, Fiscal Analysts, *Minnesota General Fund Forecasted Revenues, Fiscal Years 2006 & 2007*, http://www.house.leg.state.mn.us/fiscal/files/067fromt.pdf (forecasting that HIF will raise approximately $401 million during the 2006-07 biennium) (last visited Sept. 15, 2005).

expenditures from the General Fund.[20] The State spends more from the General Fund for healthcare than for any purpose other than K-12 education.[21] Because HIF revenue funds healthcare – a core governmental function – the Act must be considered a revenue-raising measure. *See City of North Little Rock v. Graham*, 647 S.W.2d 452, 453 (Ark. 1983) ("public safety fee" on water bill was really tax because it raised revenue for pre-existing, traditional governmental functions and services rather than funding special services provided to payers).[22]

Third, nothing suggests that the Act is truly an "exercise of the police power for the licensing or regulation of the [cigarette] business." *Ramaley*, 33 N.W.2d at 21. Minnesota has licensed tobacco distributors since 1947. *See* Act of Apr. 28, 1947, ch. 619, § 4, 1947 Minn. Laws 1126-27 (codified as amended at Minn. Stat. § 297.04

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[20] *See* Minnesota Dep't of Human Services, About DHS, *Department Overview*, http://www.dhs.state.mn.us/main/groups/agencywide/documents/pub/DHS_id_000256.hcsp (last visited Sept. 15, 2005).

[21] Minnesota Department of Finance, Minnesota State Budget, *General Fund Piecharts*, http://www.budget.state.mn.us/budget/summary/charts/050816_piecharts.pdf (last visited Sept. 15, 2005).

[22] Although the Act requires HIF revenue to be transferred into the General Fund to pay for healthcare expenses, *see* Act § 1, subd. 3, it was widely reported as a measure intended to fund K-12 education by freeing up otherwise-encumbered General Fund dollars. *See, e.g.*, Bill Salisbury, *Pawlenty Battered, Unbowed at Capitol*, St. Paul Pioneer Press, July 17, 2005, at 1A ("The revenue from Pawlenty's cigarette charge won't go directly to schools, but it will free up money in the general fund for that purpose."); Bob Geiger, *MN Marketing Briefs: June 11, 2005*, Finance & Commerce (Minneapolis, MN), (quoting Governor's press secretary Brian McClung as explaining that Governor offered HIF "in the spirit of finishing this legislative session and to fund K-12 education and welfare"). Because it funds both healthcare and education, the Act actually raises revenue for two core governmental functions.

(1949)). The State's current licensing regime is contained in Chapter 297F. Under the provisions of that chapter, it is unlawful to distribute cigarettes without a license. *See* Minn. Stat. § 297F.03, subd. 1. License applications must be submitted to the Commissioner and "must be accompanied by a fee of $300." *Id.* subds. 2, 5. Obtaining a license is a condition precedent that allows a person "to engage in business as a distributor. . . ." *See id.* subd. 7. The Commissioner enforces this licensing regime. *See* Minn. Stat. § 297F.02, subds. 1-2.

Like the challenged tax in *Ramaley* – and unlike the true regulatory provisions of Chapter 297F:

- The Act establishes no new requirements for obtaining a license.
- Payment of the HIF "confers no right or privilege to engage in the [cigarette] traffic, and it neither enlarges nor changes any privilege already possessed."
- Payment of the HIF "is not a condition precedent to the right to do business."

See Ramaley, 33 N.W.2d at 21. Indeed, just as in *Ramaley*, "the privilege or right to operate could be acquired only by payment of a license fee under an entirely different [statute]." *Id.*[23]

The foregoing analysis under *Ramaley* demonstrates that the HIF is a tax. Consideration of other factors

[23] Failure to pay the HIF can lead to license suspension or revocation. *See* Act, § 2, subd. 8. But since failure to pay the excise tax can also have these consequences, *see* Minn. Stat. § 297F.04, subd. 1, they plainly do not make the HIF a "fee."

confirms this conclusion. Courts, for example, sometimes look to the manner in which a government exaction is collected. *See, e.g., Wetzel County Solid Waste Auth. v. West Virginia Div. of Nat. Res.*, 462 S.E.2d 349, 356 (W.Va. 1995) (court's previous decision declaring fire service "charge" a tax rather than a fee focused on the "method the municipality used to collect" the charge).

Here, the manner in which the State collects the HIF also shows that it is a tax. The HIF is administered by the Commissioner under the very same provisions governing the State's existing cigarette excise tax: "The audit, assessment, interest, appeal, refund, penalty, enforcement, administrative, and collection provisions of chapters 270C [Department of Revenue] and 297F apply to the fee imposed under this section." Act § 2, subd. 6. Moreover, the legal "incidence" of the HIF and the cigarette excise tax are identically stated.[24] Finally, "[a] distributor must pay the fee *at the same time and in the same manner* as provided for payment of tax under chapter 297F." Act § 2, subd. 4 (emphasis added). The shared administration, identical incidence, and contemporaneous payment of the HIF and the cigarette excise tax indicate that the HIF is a tax.[25]

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[24] *Compare* Act § 2, subd. 3(a) *with* Minn. Stat. § 297F.05, subd. 1 (both imposing exactions upon "the sale of cigarettes in this state, upon having cigarettes in possession in this state with intent to sell, upon any person engaged in business as a distributor, and upon the use or storage by consumers").

[25] Utterly in spite of these facts, the district court found that the manner of collection "militate[s] *against* finding [the HIF] is a tax." App. at 13 (emphasis added).

Courts likewise focus on "whether there is a direct relationship between the fee charged and the service received by those who pay the fee, or between the fee charged and the burden produced by the fee payer." *See Okeson*, 78 P.3d at 1286. Here, the HIF is collected from cigarette distributors. *See* Act § 2, subd. 1. Distributors, however, receive no special benefit from the HIF. It neither pays for additional healthcare services provided exclusively to distributors, nor for the costs of regulating their business. Instead, the fee is collected to pay for healthcare, "a general benefit to the public, of a sort often financed by a general tax." *San Juan Cellular Tele.*, 967 F.2d at 685.

The HIF is certainly collected to raise revenue for customary government services *ultimately necessitated by* the business of distributing cigarettes, viz., state healthcare costs associated with smoking. But this revenue-raising purpose simply underscores the conclusion that the HIF is a tax. While the State may charge greater fees to businesses that are more costly to regulate, *e.g.*, those requiring extensive inspections[26] or those that may degenerate into nuisances,[27] fees must still be proportional to the *regulatory burden* imposed by the business. *See, e.g., State v. Labo's Direct Serv.*, 44 N.W.2d 823, 825-27 (Minn. 1950); *City of Mankato v. Fowler*, 20 N.W. 361, 362 (Minn. 1884). The costs recoverable by a fee "must be only the cost of *regulating the business itself* and not the general public, who may also become patrons of the business or who

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[26] *See, e.g., San Juan Cellular Tele.*, 967 F.2d at 686; *Mississippi Power & Light Co. v. United States Nuclear Regulatory Comm'n*, 601 F.2d 223, 225-29 (5th Cir. 1979).

[27] *See Martin*, 145 N.W.2d at 384; *City of Duluth v. Marsh*, 73 N.W. 962, 962 (Minn. 1898).

incidentally benefit by increased safety because of the city's use of police." *State v. N. Raceway Corp.*, 381 N.W.2d 526, 529 (Minn. Ct. App. 1986) (emphasis added). Where a measure raises revenue to pay for core government services – rather than for the costs of regulation – the measure is a tax.[28] The district court completely ignored this principle. *See* App. at 8-10.

The earmarking of revenue, and the segregation of such revenue into a special fund, does *not* magically change the HIF into a fee. *See Okeson*, 78 P.3d at 1286. In *Okeson*, the City of Seattle passed an ordinance "transferring the responsibility to pay for streetlights from Seattle's general budget" to the customers of the city's electric utility. *Id.* at 1282. Rate increases were paid into a "Light Fund," which was separate from Seattle's general fund. Proceeds from the Light Fund were used "to pay for street lighting and streetlight improvements." *Id.* at 1282, 1286. "Except for streetlights, Seattle otherwise continued to pay for its electricity usage." *Id.* at 1282. Ratepayers, among others, challenged the ordinance. *Id.* at 1283-84.

The court held that the ordinance imposed a tax rather than a fee. *Id.* at 1285-87. The court first concluded that providing public streetlights is a governmental function, *id.* at 1284-85, and that the purpose of the ordinance was to raise revenue (indicating that it imposed a tax). *Id.* at 1286. The court then observed that revenue generated by the ordinance was placed into the Light

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[28] The general public clearly perceives the HIF as a tax rather than a fee. *See, e.g.*, Minnesota State Senate, *2005 State Fair Poll* (reporting that 78.5 % of respondents in unscientific survey of 4820 Fair attendees believed HIF is tax), http://www.senate.leg.state.mn.us/departments/secretary/info/statefair/2005/fair_survey.pdf.

Fund and was used for streetlights and improvements. *Id.* At first blush, this "point[ed] to the cost shifting as a regulatory fee, and not a tax." *Id.* But the court emphasized that substance ultimately governs labels:

> Although depositing funds into a special account established for the stated purpose indicates it is a fee, it is important that it serves a regulatory purpose. All funds could be deposited into special accounts, and that would not necessarily turn taxes into fees. If the costs imposed do not regulate the activity, then the increased rates would, by definition, not be allocated for an authorized "regulatory" purpose. They would simply be a clever device by which taxes are guised as fees by virtue of the account in which they are deposited. Because the charges for street lighting serve no regulatory purpose, [the ordinance] cannot impose a fee just by putting those costs into the Light Fund.

Id. Although earmarking revenues and placing them into a special fund can support the finding that a legislative exaction is a fee, *see Country Joe, Inc.*, 560 N.W.2d at 686, a tax does not automatically become a fee merely due to such an arrangement. That determination ultimately turns on genuine purpose and effect of a legislative enactment.

3. Specifically, The HIF Is A Special Excise Tax Upon The Business Of Distributing Cigarettes.

The HIF is a tax because its purpose and effect are to raise revenue for a core governmental function. Although it is sufficient for present purposes to conclude simply that the HIF is a tax, a more precise classification is possible.

Specifically, the HIF is an excise tax that constitutes a "special tax" upon the business of distributing cigarettes.

An excise tax is a revenue-raising measure "imposed directly by the legislature without assessment . . . ." *Pullman Co. v. Comm'r of Taxation*, 25 N.W.2d 838, 848 (Minn. 1947) (Magney, J., dissenting) (quoting 51 Am.Jur., *Taxation*, § 35). An "excise" is "[a] tax imposed on the manufacture, sale, or use of goods (such as a cigarette tax). . . ." *Black's Law Dictionary* 605 (8th ed. 2004). Because the HIF is imposed with – and in precisely the same manner as – the State's cigarette excise tax, the HIF is a tax as well.

The Act's public health and regulatory purposes are entirely consistent with the imposition of an excise tax. Indeed, the familiar term "sin tax" is defined as "[a]n excise tax imposed on goods or activities that are considered harmful or immoral (such as cigarettes, liquor, or gambling). – Also termed *repressive tax*." *Black's Law Dictionary* 1499 (8th ed. 2004). Indeed, the Ninth Circuit Court of Appeals recently recognized that there is "a long history of excise taxation directed at particular industries in the name of public health and welfare." *R.J. Reynolds Tobacco Co. v. Shewry*, 423 F.3d 906, 922 (9th Cir. 2005), *petition for cert. filed*, 74 U.S.L.W. 3407 (U.S. Jan. 6, 2006) (No. 05-867); *see also id.* at 921 ("Nor is it a novel feature of American government to levy an excise tax on a particular industry and then use the proceeds of that tax in ways that regulate that industry.").

The HIF can also be classified as a "special tax," which is: "1. A tax levied for a unique purpose. 2. A tax (such as an inheritance tax) that is levied in addition to a general tax." *Black's Law Dictionary* 1499 (8th ed. 2004).

The term "special tax" embraces an exaction imposed upon particular taxpayers to recover state costs thought to be associated with those taxpayers:

> In some instances the expense of a particular public function is met in whole or in part by a tax on those who will benefit by the maintenance of such function or who may be supposed to have caused the expense to be incurred . . . Moreover, a special tax has been taken to mean an exaction which a taxing power may impose in addition to the general levy, as, for example, road taxes. . . .

71 Am.Jur.2d *State and Local Taxation* § 21 (1973) (citations omitted).

This Court has held, for example, that "[t]he gasoline excise tax was a 'special tax' imposed on the business of dealing in gasoline, with the purpose of raising revenue for maintenance and construction of the Trunk Highway System." *Amoco Corp. v. Comm'r of Revenue*, 658 N.W.2d 859, 872 (Minn. 2003). The HIF is likewise a special tax on the business of distributing cigarettes to raise revenue for state healthcare costs associated with smoking.

The Act's express purpose is to raise revenue that is transferred to the General Fund to finance a customary governmental function – providing healthcare. It has no true regulatory purpose. Consequently, the HIF is a tax rather than a fee. As this Court has said: "When it has been apparent that a city's true motivation was to raise revenue – and not merely to recover the costs of regulation – we have disregarded the fee label attached by a municipality and held that the charge in question was in fact a tax." *Country Joe, Inc.*, 560 N.W.2d at 686.

The Agreement did not contract away the State's power to tax the distribution of cigarettes. Because the HIF is in substance a tax, imposing the HIF on Defendants' Distributors does not breach or impair the Agreement. *See supra*, Arg. § I.D.[29]

IV. EVEN IF THE DISTRICT COURT PROPERLY ENJOINED THE COMMISSIONER FROM ENFORCING THE HIF AGAINST DEFENDANTS' DISTRIBUTORS, IT ERRED BY RULING THAT CONTINUED ENFORCEMENT AGAINST INTERVENORS VIOLATES EQUAL PROTECTION GUARANTEES.

Having enjoined the Commissioner from enforcing the HIF against Defendants' Distributors, the district court determined that if it allowed continued enforcement against Intervenors, they would be "singled out and deprived of equal protection under the Uniform Taxation Clause of the Minnesota Constitution." App. at 17. This "selective enforcement" would be improper because none of the Act's "goals will be fulfilled" and because "what is left [of the Act] are distinctions which are manifestly arbitrary and fanciful." *Id.* The court also concluded that "[r]equiring [Intervenors] to pay the H.I.F. would be the functional equivalent of a special legislation singling out for special privilege the settling defendants and in derogation of the nonsettling defendants under Art. 12, Sec. 1,

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[29] Having erred in finding breach and impairment, the district court further erred by ruling that Defendants and Intervenors are entitled to refunds of amounts paid. *See* App. at 9. Neither Defendants nor Intervenors ever requested this relief. *See* App. at 1-5 (Defendants' motion). Consequently, the issue of possible refunds was not raised, briefed or argued. The district court clearly erred by reaching out to address this issue.

Minnesota Constitution." *Id.* at 17-18. The court thus enjoined the Commissioner from enforcing the HIF against Intervenors. *Id.* at 9. These rulings were error.

A. The Standard Of Review Under Relevant Equal Protection Guarantees Is Highly Deferential.

The Fourteenth Amendment to the United States Constitution provides in part that no state shall "deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1. Article I, section 2 of the Minnesota Constitution provides in part that "[n]o member of this State shall be . . . deprived of any of the rights or privileges secured to any citizen thereof, unless by the law of the land or judgment of his peers." Minn. Const. art. I, § 2. The Uniformity Clause of the Minnesota Constitution provides in part that "[t]axes shall be uniform upon the same class of subjects. . . ." Minn. Const. art. X, § 1.

When addressing challenges under these equal protection and uniformity provisions, this Court has held that "the scope of their restrictions on the legislative power to tax and to classify is identical. . . ." *J.L. Shiely Co. v. County of Stearns*, 395 N.W.2d 357, 359 (Minn. 1986). Moreover, if the challenge "involves neither a suspect classification nor a fundamental right, [courts] review the challenge under a rational basis standard." *Kolton v. County of Anoka*, 645 N.W.2d 403, 411 (Minn. 2002); *see also John Hancock Mut. Life Ins. Co. v. Comm'r of Revenue*, 497 N.W.2d 250, 253 (Minn. 1993) ("The proper standard of review of a challenged economic classification is the rational basis test. . . .").

The federal rational basis test requires a court to determine "whether the challenged classification has a legitimate purpose and whether it was reasonable to believe that use of the challenged classification would promote that purpose." *Kolton*, 645 N.W.2d at 411 (citations omitted). The Minnesota rational basis test requires that:

> (1) The distinctions which separate those included within the classification from those excluded must not be manifestly arbitrary or fanciful but must be genuine and substantial, thereby providing a natural and reasonable basis to justify legislation adapted to peculiar conditions and needs; (2) the classification must be genuine or relevant to the purpose of the law; that is there must be an evident connection between the distinctive needs peculiar to the class and the prescribed remedy; and (3) the purpose of the statute must be one that the state can legitimately attempt to achieve.

Id. at 411 (citations omitted).[30]

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[30] The Court uses this same three-factor test to adjudicate challenges brought under the Special Legislation section of the Minnesota Constitution. *See In re Tveten*, 402 N.W.2d 551, 558-59 (Minn. 1987). That section provides in part as follows:

> The legislature shall pass no local or special law . . . granting to any private corporation, association, or individual any special or exclusive privilege, immunity or franchise whatever . . . . The inhibitions of local or special laws in this section shall not prevent the passage of general laws on any of the subjects enumerated.

Minn. Const. art. XII, § 1. By its terms, this provision applies exclusively to the Legislature and to "laws." Intervenors, however, did not challenge the Act *as passed by the Legislature*. For this reason, continued

(Continued on following page)

Judicial review under these rational basis tests is limited to the basic rationality of legislation; it does not extend to questions of "either the factual accuracy or political wisdom of the reasoning and judgments underlying the legislative enactment." *AFSCME Councils 6, 14, 65 & 96 v. Sundquist*, 338 N.W.2d 560, 570 (Minn. 1983). Challenged legislation will be sustained as having a rational basis "if any conceivable state of facts supports it." *Rio Vista Non-Profit Housing Corp. v. County of Ramsey*, 335 N.W.2d 242, 245-46 (Minn. 1983).

Under the rational basis test, "[e]very presumption [is] invoked in favor of the constitutionality of an act of the legislature." *Contos v. Herbst*, 278 N.W.2d 732, 736 (Minn. 1979). Accordingly, "[t]he party challenging the constitutionality of [a] statute bears the burden of establishing 'beyond a reasonable doubt' that the statute violates a constitutional right." *Westling v. County of Mille Lacs*, 581 N.W.2d 815, 819 (Minn. 1998). Although rational basis review is always deferential, "courts are especially deferential in the context of classifications made by complex tax laws." *John Hancock*, 497 N.W.2d at 253 (internal quotation marks and citations omitted).

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enforcement cannot violate the Special Legislation provision. In any event, continued enforcement easily passes the three-part test.

B. Because Continued Enforcement Of The HIF Against Intervenors Satisfies Minnesota's Three-Factor Rational Basis Test, It Comports With State And Federal Equal Protection Principles.

Because the Act satisfies Minnesota's three-factor rational basis test, it comports with equal protection and uniformity principles. First, the State clearly may attempt to achieve the purposes specified by the Act.[31] One goal of the Act is to recover healthcare costs associated with tobacco use. *See* Act § 2, subd. 1. Courts have determined that recovering tobacco-related state healthcare expenses is a legitimate state purpose. *See, e.g., Star Scientific v. Beales*, 278 F.3d 339, 349, 352 (4th Cir.), *cert. denied*, 537 U.S. 818 (2002); *PTI, Inc. v. Philip Morris, Inc.*, 100 F. Supp. 2d 1179, 1207 (C.D. Cal. 2000). The Act's other aim is to deter smoking, particularly by youth. *See* Act § 2, subd. 1. There can be no doubt that deterring underage smoking is a legitimate state interest. *See Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 564 (2001) ("The State's interest in preventing underage tobacco use is substantial, and even compelling. . . .").

Second, the classification resulting in continued enforcement is relevant to the purpose of that enforcement. Because the Act imposes the HIF on the distribution and sale of *all* cigarettes, *see* Act § 2, subd. 3, the Legislature plainly intended to pursue the Act's stated purposes as broadly as possible. Because it granted specific performance, the district court obviously concluded that a

[31] As this Court has done, the State will address the three factors in reverse order. *See Metro. Sports Facilities Comm'n v. County of Hennepin*, 478 N.W.2d 487, 489 n.4 (Minn. 1991).

contractual release prevented the Commissioner from enforcing the HIF against Defendants' Distributors. That ruling plainly prevented the Act's purposes from being accomplished as to distribution and sale of all cigarettes. *See* App. at 17. But the enforcement of a tax of general application against fewer than all taxpayers originally covered by the tax does not violate equal protection principles. *See Cherokee State Bank of St. Paul v. Wallace*, 279 N.W. 410, 413-15 (Minn. 1938) (ruling that general tax subsequently held unenforceable against national banks could still be enforced against state banks).[32]

Here, a judicial determination will have placed certain taxpayers beyond the reach of the Commissioner's enforcement authority. The resulting "classification" distinguishes between those distributors who are beyond the Commissioner's enforcement authority (Defendants' Distributors) and those who remain within that authority (Intervenors). This "classification" is not irrational where the Act continues to pursue its purposes to the greatest extent legally possible.[33]

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[32] *Accord Union Bank & Trust Co. v. Phelps*, 288 U.S. 181 (1933); *see also Hixon v. City of Philadelphia*, 32 Pa. D. & C. 436 (Pa. Ct. Com. Pleas 1938) (court invalidated general tax as to parking lots owned by corporations but held that lots owned by individuals were still subject to tax because resulting classification was reasonable).

[33] *Cf. Kolton*, 645 N.W.2d at 411 ("consistently with the Equal Protection Clause, a State may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind. . . . The legislature may select one phase of one field and apply a remedy there, neglecting the others.") (internal quotation marks omitted) (quoting *Geduldig v. Aiello*, 417 U.S. 484, 494-95 (1974)).

Finally, there is nothing arbitrary about the distinction between taxpayers to whom a law can be applied, and those to whom it cannot. Indeed, this is the very distinction the district court drew. It is obviously genuine (based on a meaningful legal difference) and substantial (based on a legal difference that really matters). Continued enforcement of the Act does not violate equal protection or uniformity principles.

CONCLUSION

For the above stated reasons, the State respectfully requests that this Court reverse the December 20, 2005 decision of the district court in its entirety.

Dated: _____

Respectfully submitted,

MIKE HATCH
Attorney General
State of Minnesota

_____

BRADFORD S. DELAPENA
Assistant Attorney General
Atty. Reg. No. 219046

MICHAEL J. VANSELOW
Deputy Attorney General
Atty. Reg. No. 152754

445 Minnesota Street, Suite 900
St. Paul, MN 55101-2127
(651) 296-0987

ATTORNEYS FOR APPELLANT
STATE OF MINNESOTA

CERTIFICATE OF COMPLIANCE
WITH MINN. R. APP. P 132.01, Subd. 3

The undersigned certifies that the Brief submitted herein contains 13,944 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedure 132. This Brief was prepared using a proportional spaced font size of 13 pt. The word count is stated in reliance on Microsoft Word 2003, the word processing system used to prepare this Brief.

BRADFORD S. DELAPENA

No. A05-2540

STATE OF MINNESOTA
IN SUPREME COURT

The State of Minnesota,
by Hubert H. Humphrey III,
its then Attorney General, *et al.*,

Petitioner,

vs.

Philip Morris USA, Inc., *et al.*,
and
A.H. Hermel Candy & Tobacco Co., *et al.*

Respondents.

GOVERNOR TIM PAWLENTY'S AMICUS BRIEF AND APPENDIX

KAREN A. JANISCH, ESQ.
130 State Capitol
75 Constitution Avenue
St. Paul, MN 55155
(651) 282-3705

Attorney for Amicus Curiae Governor Tim Pawlenty

MIKE HATCH
Attorney General
State of Minnesota
BRADFORD S. DELAPENA
(#219046)
Assistant Attorney General
MICHAEL J. VANSELOW
(#152754)
Deputy Attorney General
445 Minnesota Street, Suite 1100
St. Paul, Minnesota 55101-2128
(651) 296-0987

Attorneys for Petitioner

(Additional Counsel Listed on following page)

2006 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 –
PHONE (612) 339-9518 OR 1-800-715-3582

EDWARD B. MAGARIAN, ESQ.
PETER SIPKINS, ESQ.
Dorsey & Whitney LLP
50 South Sixth Street, Suite 1500
Minneapolis, MN 55402
(612) 340-7873

BRENT R. LINDAHL, ESQ.
SCOTT G. KNUDSON, ESQ.
Briggs and Morgan
2200 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 977-8400

WALTER A. PICKHARDT, ESQ.
Faegre & Benson, LLP
2200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402
(612) 766-8622

THOMAS H. BOYD, ESQ.
KARL E. ROBINSON, ESQ.
Winthrop & Weinstine, PA
Suite 3500
225 South Sixth Street
Minneapolis, MN 55402-4629
(612) 604-6400

RANDY G. GULLICKSON ESQ.
Anthony Ostlund & Baer, P.A.
90 South Seventh Street, Suite 3600
Minneapolis, MN 55402
(612) 349-6969

Attorneys for Respondents

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Josephine Marcotty, *75 Cents More Per Pack Is A Push To Quit; New Fee Increase Is Driving Many Smokers To Seek Help*, Minneapolis Star Tribune, August 28, 2005, at 1A 13

SUMMARY OF THE ARGUMENT*

Under the Minnesota Constitution, the legislature has the sole power to enact laws to protect the health and welfare of citizens and to regulate business within the state. The Health Impact Fee Act ("HIF Act")[1], 2005 Minn. Laws, 1st Sp. Sass., Ch. 4, Art. 4, §§ 1-6 (A 33-36)[2], is the legislature's most recent exercise of its police powers to regulate cigarette and tobacco products[3] The HIF Act increases the consumer price of cigarettes, thereby reducing smoking, particularly among youths. The HIF portion of the higher consumer price flows to the state thereby requiring tobacco users to offset some of the state's significant health care costs attributable to tobacco use. HIF §2, subd. 1 (A 34).

This appeal raises significant questions regarding the scope of the attorney general's authority in entering agreements to settle the state's litigation. The Tobacco Companies argue that the release language in entering

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* Counsel for governor Tim Pawlenty authored the brief in whole and no other person or entity made a monetary contribution to the preparation or submission of the brief.

[1] References to the HIF Act will be "HIF §___subd.___."

[2] References to the Appellant's Appendix will be "(A ___)."

[3] The Tobacco Defendants, their distributors and the Intervenors are cigarette manufacturers, licensed distributors of cigarettes or their representatives. The Settlement Agreement applies only to cigarettes and smokeless tobacco manufactured by the Tobacco Companies. (A 41-42). It does not apply to other tobacco products, such as cigars, which are within the HIF Act. The district court's order is specific to these parties and, therefore, is specific only to the HIF Act's provisions regarding these products. The Governor's brief will focus on the specific laws relating to the sale of cigarettes in Minnesota. The same arguments apply in relation to other tobacco products.

the 1998 Settlement Agreement grants their distributors the right to be free from future laws related to the state's health costs associated with tobacco products, including the HIF Act. The Intervenors, who have not entered into any contract with the state, assert that they are likewise exempt from state regulation because the Tobacco Companies distributors represent such a large share of the state market.

The Settlement Agreement does not exempt the Tobacco Companies from future taxes, fees or regulation of either cigarettes or tobacco products. Such a broad release is unwarranted by the language of the Settlement Agreement, would usurp the powers of the legislature and violate the separation of powers mandate of the Minnesota Constitution.

The HIF Act is a valid exercise of the state's police powers and serves important public policy interests. The ability of the legislature to enact laws to serve the public interest cannot be contracted away. Any action by the attorney general to impede the legislative powers of the state is *ultra vires* and therefore does not prevent application of the HIF Act to the Tobacco Companies' distributors.

Moreover, even if the Settlement Agreement could be interpreted to "release" the Tobacco Companies' distributors from future state regulation and even if the attorney general had authority to bind the state in such a manner, it is well settled that every contract entered by the state is subordinate to the state's valid exercise of its police powers.

In determining whether a state law unconstitutionally infringes upon a contract right, the courts balance the public interest furthered by the law against the nature of

the impairment. In this case, the HIF Act furthers important public purposes of protecting health and welfare, as well as requiring that tobacco consumers bear financial responsibility for the financial costs to the state stemming from their tobacco use. These important interests are not an unconstitutional impairment of contract.

The Court should reverse the district court's order and uphold the validity of the HIF Act as applied to the Tobacco Companies, their distributors and the Intervenors. If, however, the Court finds an unconstitutional impairment of the Settlement Agreement, the Court should address the issue of an appropriate remedy and fashion a narrow remedy that permits the state to implement as much of the HIF Act as constitutionally permitted.

ARGUMENT

I. THE ATTORNEY GENERAL LACKED AUTHORITY TO CONTRACT AWAY THE LEGISLATIVE POWERS OF THE STATE.

The State's brief argues that the separation of powers doctrine must be read into the Settlement Agreement. In this case, however, the Settlement Agreement itself expressly limits its scope to the actions validly taken by the attorney general. The terms "State" and "State of Minnesota" are expressly defined to include only "the State of Minnesota acting by and through its Attorney General." (A 40). The Agreement does not purport to bind the state in relation to matters that require the state to act through its legislature. Thus, the parties have expressly agreed to bind the state only to the extent the attorney general could validly act on behalf of the state.

This appeal presents issues regarding the scope of the attorney general's authority to enter a settlement agreement that has as a term the "release" of private parties from future laws. If the attorney general lacked the power to enter a contract to bind the state's legislature in such a manner, the definition of "State" in the contract compels a determination that the contract does not contain such a provision. In the alternative, such a provision would be *ultra vires* and unenforceable.

A. The Minnesota Constitution Places the Legislative Powers of the State with the Legislature.

"Government is instituted for the security, benefit and protection of the people, in whom all political power is inherent, together with the right to alter, modify or reform government whenever required by the public good." Minn. Const art. I, § 1. The Minnesota Constitution provides:

> The powers of government shall be divided into three distinct departments: legislative, executive and judicial. No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others except in the instances expressly provided in this constitution.

Minn. Const art. III.

The limitations on government officials established by the separation of powers mandate are well-settled.

> The powers and duties of each department are distinctly defined. The departments are independent of each other to the extent, at least, that

> neither can exercise any of the powers of the others not expressly provided for. . . . This not only prevents an assumption by either department of power not properly belonging to it, but also prohibits the imposition, by one, of any duty upon either of the others not within the scope of its jurisdiction; and "it is the duty of each to abstain from and to oppose encroachments on either."

Matter of Application of Senate, 10 Minn. 78, 81 (1865). A constitutional grant of power to one of the three branches of government is a *denial* of that power to the other branches. *Bloom v. Am. Express Co.*, 222 Minn. 249, 256, 23 N.W. 570, 575 (1946).

The Minnesota Constitution vests the state's legislative powers with the legislature. Minn. Const art. IV. Exercise of the state's police powers through the enactment of laws is a legislative function. *State ex rel. Beery v. Houghton*, 164 Minn. 146, 151, 204 N.W. 569, 571 (1925); *State ex rel. Village of Clara City v. Great N. Ry. Co.*, 130 Minn 480, 485, 153 N.W. 879, 880 (1915). The Constitution does not grant the attorney general any legislative power, and he is, therefore, denied such power. *Bloom*, 222 Minn. at 256, 23 N.W. at 575.

The importance of the state's police powers cannot be disputed. In *State ex rel. Pavlic v. Johannes*, 194 Minn. 10, 11-12, 259 N.W. 537, 537 (1935), the Supreme Court described the police powers as:

> That doctrine, too well settled to admit of doubt, is that the police power of a state may be invoked to regulate private enterprise whenever the general welfare of the people is to he furthered or protected, and the legislature has a large discretion to determine not only what the best interests of

> the public require but the manner in which such interest may best be protected.

Even where the constitution expressly grants legislative power to an executive branch official, the Court has been careful to narrowly interpret such power to protect the legislature's constitutional powers. For example, the governor, through his power to sign or veto legislation, is granted limited legislative power under the constitution. Minn. Const. art. IV, § 23. The Court has been careful to interpret the governor's veto authority narrowly "to prevent an unwarranted usurpation by the executive of powers granted the legislature in the first instance." *Inter Faculty Org. v. Carlson*, 478 N.W.2d 192, 194 (Minn. 1991).

The Tobacco Companies assert that the object of the release language was to prevent future legislation. In other words, its express purpose was to limit the legislature's power to enact future laws in this subject area. The release argued by the Tobacco Companies is not grounded in an assertion that enforcement of the HIF Act is a legal claim that was, or could have been, raised by the attorney general in the underlying Tobacco Litigation. Thus, this case does not present a situation where a contract has an unanticipated or incidental conflict with legislation. Rather, the purported contract term is asserted to have as its goal a limitation on future legislative power. The attorney general could not validly make such a promise.

The constitution's denial of legislative power to the attorney general is dispositive. Moreover, an examination of the state's cases relating to the waiver of the state's police powers, and the cases addressing the common law authority of the attorney general confirm this conclusion. The attorney general simply does not have authority to

contract away the legislature's power to determine the current and future legislative policy for the state.

1. The Legislature Did Not, Through its Acts, Grant the Attorney General Authority to Limit Its Future Exercise of Its Police Powers.

The State's brief addresses the well-settled doctrine of unmistakability in relation to any waiver of the state's police powers and those arguments will not be repeated here. Two supplemental points about this doctrine, however, are important.

First, the unmistakability doctrine arguably provides only an initial means for the Court to reject interpretation of a contract in denigration of the state's sovereign powers. In developing the unmistakability doctrine, the Court has questioned the ability of the legislature to waive the police powers even by a clearly expressed intent to do so. *See Grisom v. S. St. Paul Live Stock Exch.*, 152 Minn. 271, 276, 188 N.W. 729, 731 (1922) ("[a]ll contracts relating to matters within the domain of the power are subject to the exercise thereof, for the legislature cannot surrender it or bind the state not to exert it"); *accord State ex rel. St. Paul v. Chicago M & S. P.R. Co.*, 135 Minn. 277, 280, 160 N.W. 773 (1916) ("[t]he police power cannot be surrendered nor divested nor abridged nor bargained away . . . [o]ne legislative body cannot deprive its successor of it"); *State v. Smith*, 58 Minn. 35, 38, 59 N.W. 545, 546 (1894) ("even if it were conceded that the legislature can, by contract or by giving authority to make a contract, bind the state not to exercise the police power, the legislative intent to do so would have to appear unmistakably"). These cases suggest

that the legislature may not even be capable of bargaining away the powers of future legislature to enact laws for the public benefit – even if it had the clear intent to do so.

Second, the question raised by the unmistakeability doctrine is the *legislature's* clear intent to surrender the state's police powers. Nothing permits an executive branch official to bind the legislature's police powers without having been given that clear contract authority by the *legislature.* In this case, there was no such grant of authority by the legislature. The 1998 Settlement Agreement was entered solely by the attorney general exercising the powers of that office to resolve the state's legal claims. The Agreement was not authorized by, negotiated by or ratified by the state legislature.[4]

2. The Attorney General Had No "Common Law" Power to Impair the Legislature's Powers.

The attorney general's common law powers do not vest him with the authority to curtail the legislature's exercise of its legislative power. This Court has recognized that the

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[4] In *Lawyer v. Department of Justice*, 521 U.S. 567 (1997), the United States Supreme Court addressed the validity of a settlement of a redistricting dispute. The court recognized the power of the state's attorney general to represent the state in the proceeding and to propose a plan for settling the dispute. *Id.* at 577. In upholding the proposed redistricting plan, the court recognized that the legislature had participated in the litigation and given approval for the attorney general to offer the plan. *Id.* In addition, the court expressly recognized that the settlement did not prevent the legislature's authority to develop a new plan that differed from the one approved through the settlement. *Id.*

attorney general has *common law powers* to bring and maintain litigation:

> As the chief law officer of the state, the attorney general possesses all of the powers inherent in that office at common law. * * * The attorney general may institute, conduct, and maintain all such actions and proceedings as he deems necessary for the enforcement of the laws of this state, the preservation of order, and the protection of legal right.

Humphrey v. McLaren, 402 N.W.2d 535, 539 (Minn. 1987); *accord Slezak v. Ousdigian*, 110 N.W.2d 1, 5 (Minn. 1961).

The Minnesota courts have not, however, specifically addressed the scope of the attorney general's common law authority to enter contracts settling the state's legal claims. Arguably, the authority of the attorney general to initiate litigation includes the authority to dismiss such actions. In addition, the well-settled doctrine of *res judicata* suggests that the attorney general has the power to accept dismissal of actual claims, or waiver of any claims that could have been raised as part of the litigation.

There is, however, no authority in common law that grants the attorney general the authority to resolve existing litigation by agreeing to "release" a private party from potential future litigation that is based on future conduct, and that could not have been raised in relation to existing claims. Such a broad release of future litigation would unquestionably limit the discretion of future attorneys general to determine the state's legal positions and act in the best interests of the state as the future circumstances dictates. The Minnesota courts have commented on the duty on the legislature to refrain from binding a

future legislature's exercise of its police powers. *See Grisom*, 152 Minn. at 276, 188 N.W. at 731, *State ex rel. St. Paul*, 135 Minn. at 280.

In the instant case, the interpretation of the release language in the Settlement Agreement presents an even more attenuated situation than the release of future adjudicatory claims. Here, the Tobacco Companies assert that the attorney general had authority to promise a private party exemption from future types of regulation by the state. There is no common law basis for this authority.

Permitting the attorney general such unfettered contract authority is contrary to public policy and would permit the power of the chief legal officer to subsume the powers of the entire legislative branch. It would also allow the attorney general, through settlement agreements, to grant exclusive privileges, rights and exemptions to private individuals in a manner that the constitution expressly denies to the legislature. The constitution prohibits the legislature from enacting any special laws that grant private parties any special privilege, immunity, or franchise. Minn. Const. Art. XII, § 1. The legislature could not have passed a law granting the Tobacco Companies distributors' (and not others) exemption from future legislative exactions, license requirements or state laws. The attorney general should not be given authority to grant such special exemptions from current or future laws under the guise of settling the state's legal claims.

B. The Legislature Did Not Ratify the Release Provision of the Agreement.

The legislature did not authorize the Tobacco litigation, did not participate in the settlement negotiations, and the 1998 Agreement was never submitted to the legislature for ratification. The district court dismissed, without analysis, the State and Governor's separation of powers arguments asserting, without any authority, that the legislature "acquiesced" in the release provision limiting its authority when it enacted Minn. Stat. § 297F.24. The district court's analysis should be rejected.

In *Edwards v. Mettler*, 268 Minn. 472, 477-78, 129 N.W.2d 805, 808 (1964) the Court recognized that "[a]cquiescence and waiver are always questions of fact. There can be neither without knowledge. . . . One cannot waive or acquiesce in a wrong while ignorant that it has been committed. * * * There must be knowledge of facts which will enable the party to take effectual action." In relation to the 2003 enactment of Minn. Stat. § 297F.24, there is no evidence in the record that the legislature was aware of the purported *ultra vires* exercise of legislative power by the attorney general, that the legislature could ratify such *ultra vires* acts, or that the Agreement's release provisions could be read to limit future legislative authority. Without specific knowledge of any assertion that the contract included a term that infringed upon legislative authority or that it exceeded the attorney general's authority, there is no basis for asserting that the legislature "acquiesced" in the infringement of its power. Indeed, the legislature's subsequent enactment of the HIF Act reflects that it did not acquiesce in any limitation of its legislative powers.

The "acquiescence" theory also contradicts the express language of the Agreement. The Agreement's limited definition of the "State" as acting through the attorney general creates a right in the state to limit the terms of the agreement to the powers validly conferred upon the attorney general. (A 40). As provided in the Agreement, any waiver of a right conferred by the Agreement must be in writing to be effective. (A 62).

II. Even If The Agreement Released Future Legislative Acts, The State's Valid Exercise Of Its Police Powers Overrides The Contractual Provision.

Assuming for the purposes of argument that the release provision of the Agreement could be interpreted to release the Tobacco Companies from enforcement of future regulatory actions such as the HIF, and assuming that the attorney general had the authority to agree to such a contract provision, the state may still exercise its police powers under appropriate circumstances. "All contracts made by the state are entered into subject to the implied condition that they are ever subordinate to a reasonable and proper exercise of the state's police power."[5] *Minneapolis Gas Co. v. Zimmerman,* 253 Minn. 164, 184, 91 N.W.2d 642, 645 (1958). The full and unfettered exercise of the state's police powers is tempered by the state's obligation to comply with the contracts clauses of the state and federal constitutions. *Christensen v. Minneapolis Municipal*

[5] Because the reserved power of the state to exercise its police powers is part of all contracts entered by the state, the state's valid exercise of this power cannot be a breach of the contract.

Employees Retirement Bd., 331 N.W.2d 740, 749-50 (Minn. 1983).

A. The HIF Act Furthers Important Public Purposes and Is Consistent with the Existing Regulatory Framework for Tobacco Products.

In order to understand the significant public purposes served by the HIF Act, it is important to review the manner in which the Act works in conjunction with other state laws relating to tobacco products and tobacco use.

1. The HIF Act is Intended to Decrease the Health Impacts from Tobacco Use.

In 1985, the legislature made the following findings:

(1) smoking causes premature death, disability, and chronic disease, including cancer and heart disease, and lung disease;

(2) smoking related diseases result in excess medical care costs; and

(3) smoking initiation occurs primarily in adolescence.

The legislature desires to prevent young people from starting to smoke, to encourage and assist smokers to quit, and to promote clean indoor air.

Minn. Stat. § 144.391.

The legislature has enacted numerous laws protecting the health of residents and promoting the reduction of smoking. *See e.g., Minn. Stat.* §§ 144.411 to 144.417 (Clean Indoor Air Act); *Minn. Stat.* § 144.392 to 144.396 (public

health programs to promote health, reduce smoking in youth by 25%, and to assess tobacco related behaviors); *Minn. Stat* § 609.681 (prohibiting unlawful smoking); *Minn. Stat.* § 609.685 (prohibiting tobacco related sale to and use by minors); *Minn. Stat.* § 461.19 (permitting local ordinances regarding smoking and tobacco to be more restrictive than state law).

One of the express purposes of the HIF Act is to reduce tobacco use, particularly among youths. *HIF. § 2, subd. 1 (A 34).* The HIF Act seeks to mitigate the devastating (and expensive) health problems caused by Minnesotans' use of tobacco products by increasing the retail price for a pack of cigarettes by $ 0.75, plus wholesale and retail mark-up. *HIF § 2, subd. 3 (A 34); Minn. Stat.* § 325D.30-325D.33.

In enacting the HIF, the legislators recognized the link between the increased consumer cost of cigarettes and anticipated reductions in smoking. Representative Fran Bradley, Chair of the House Health and Human Services Finance Committee, observed:

> I think that we know clearly that as we increase the cost of tobacco products we see decreases in the number of people who smoke – particularly among young people.

Floor Session of the Minnesota House of Representatives (2005 Special Session – Part 2 of 3) (July 13, 2005) (http://www.house.leg.state.mn.us/htv/1s84/hfsB071305.asx) (1 hr 28 min.)

It was immediately clear that the HIF was effective in its goal of reducing tobacco use and providing an incentive for consumers to quit. One of the local newspapers reported that since August 1, 2005:

> [S]mokers have been turning in droves to the state's quit-smoking hot lines and websites.
>
> Blue Cross and Blue Shield of Minnesota said the number of new enrollees in its stop-smoking program jumped 65 percent . . .
>
> The Minnesota Partnership for Action Against Tobacco said that compared with the first week of August a year ago, calls to its telephone help line more than doubled . . .

Josephine Marcotty, *75 Cents More Per Pack Is A Push To Quit; New Fee Increase Is Driving Many Smokers To Seek Help,* Minneapolis Star Tribune, August 28, 2005, at 1A.

2. Reduction in Use Will Reduce the State's Health Costs.

As expressly found by the legislature, the goal of reducing smoking is integrally tied with the goal of reducing the medical impacts and costs associated with smoking. *See Minn. Stat.* § 144.391. This is especially true if the increased cost prevents young people from starting to use tobacco products. *Id.*

As identified in the HIF Act, the state funds numerous programs that pay for medical care for Minnesotans. *HIF § 1, subd. 2 (A 33).* As a result of continued smoking and tobacco use, the state incurs additional costs to its medical programs as a result of Minnesotans' choice to smoke. These costs are substantial. The HIF Act is anticipated to offset approximately 400 million dollars of the state's tobacco related medical costs over the first two years of its existence. *See,* 2005 Budget Summary, House Fiscal

Analysis Department, at 84 (September 2005) (projecting a 14% decline in tobacco sales resulting from the HIF) (G 1).[6]

The HIF Act ties the goal of tobacco use reduction with the goal of reducing the health costs arising from smoking. The legislature was mindful that if consumers bore these costs through the fee, consumer behavior would change and the revenues would be diminished. *See, Id.* (projecting a 14% decline in tobacco sales resulting from the HIF) (G 1).

3. The HIF Act Makes the Consumer, Not Distributors, Pay the Health Impacts of Smoking.

The HIF Act puts the financial burden for paying the fee on consumers whose choice to smoke drives the increased medical costs to the state. The HIF Act incorporates the fee directly into the consumer price of cigarettes which is regulated through the Minnesota Unfair Cigarette Sales Act ("UCSA"). *Minn. Stat.* §§ 325D.30 - 325D.42. The UCSA sets minimum pricing for all wholesale and retail transactions of cigarettes. *Minn. Stat.* § 325D.33, subd. 1.

The HIF Act amended the UCSA to include the amount of the fee in the "basic cost of cigarettes." *HIF § 4 (A. 35).* As amended, the "basic cost of cigarettes" is defined as:

> the gross invoice cost of cigarettes to the wholesaler or the retailer plus the full face value of any stamps which may be required by any cigarette

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[6] References to the Governor's Amicus Appendix will be "(G___)."

> tax or *fee* act of this state, unless included in the manufacturer's list price.

Id.; Minn. Stat. § 325D.32, subd. 9 (2005). A wholesaler, which includes a distributor, cannot sell cigarettes for less than the "basic cost of cigarettes" plus the cost of doing business and cartage which is presumed to be 4.5% of the basic cost of cigarettes. *Minn. Stat.* § 325D.32, subd. 10. The distributor fully recovers the cost of the HIF from its sale of cigarettes.[7]

Therefore, the UCSA also requires that the increased cost of cigarettes resulting from the HIF be passed on directly to the consumer. *Minn. Stat.* § 325D.32 and 325D.33, subds. 1 and 8. The only person who is not fully reimbursed for the cost of the HIF is the consumer.

Although the consumers are the intended and ultimate payors of the HIF, the HIF Act permits the Commissioner of Revenue ("Commissioner") to collect the HIF through distributors. *HIF § 2, subd. 4 (A 34).* This is consistent with the regulatory method used for the state's collection of the cigarette tax, which like the HIF, is passed to the consumer. *Minn. Stat. § 297F.09.* Collection of the HIF at the distributor level presents a clear efficiency for the state in administration and collection of the fee. There are significantly fewer distributors than retailers and consumers. In addition, distributors already are subject to the state's extensive regulatory structure regarding

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[7] The HIF Act actually results in higher profits for distributors. If a distributor uses the presumed mark-up method, a distributor is required to sell cigarettes at a presumed mark-up of 4.5% above the basic cost of cigarettes. The $0.75 increase to the basic cost of cigarettes as a result of the HIF results in the distributors making approximately $ 0.037 more per pack of cigarettes. *C.f. Minn. Stat.* § 325D.32, subd. 10.

licensing, stamping product, the filing of reports and returns, and the reporting and auditing framework established under Chapter 297F.[8] The requirement for distributors to initially pay the HIF and recover it down the chain of market transactions reflects efficacy in administration and enforcement and consistency in collection of all fees and taxes related to cigarette transactions.[9]

B. The HIF Act Does Not Substantially Impair the Tobacco Companies' Reasonable Expectations Under the Settlement Agreement.

The Court has recognized a three-part test to review claims for constitutional impairment of a contract right.

> The initial question is whether the state law has, in fact, operated as a substantial impairment of a contractual obligation. The severity of the impairment increases the level of scrutiny to which the legislation is subjected. If there is a substantial impairment, the state, at the second step, must demonstrate a significant and legitimate public purpose behind the legislation. Third, the state's action is examined in the light of this public purpose to see "whether the adjustment of the

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[8] Distributors must keep detailed records of all receipt of product and all sales or transactions. *Minn. Stat.* § 297F.13. Distributors are also responsible for affixing the required stamp on all product prior to delivering product to any other person or at the time a distributor ships product into the state. *Minn. Stat.* § 297F.08. Distributors must submit monthly informational reports to the commissioner. *Minn. Stat.* § 297F11. Distributors must also submit monthly returns reflecting their specific use of the state stamps. *Minn. Stat.* § 297F.09.

[9] For these same reasons, the legislature also moved collection of the sales tax on cigarettes to the distributor level in 2005. *2005 Minn. Laws, 1st Sp. Sess., Ch. 3, Art. 6, § 15 and Art. 5 § 7.*

> rights and responsibilities of the contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption."

Christensen, 331 N.W.2d at 751-52 (citing *Energy Reserves Group v. Kan. Power & Light*, 459 U.S. 400, 412 (1983)).

1. No Significant Impairment.

The HIF Act does not significantly impair the Tobacco Companies' rights under the Settlement Agreement. Even if a substantial impairment is found, the important public purposes furthered by the HIF Act outweigh the minimal impairment of the Tobacco Companies asserted contract rights.

The Tobacco Companies assert that the impairment from the HIF arises because their distributors are required to remit the fee to the state. They assert that these remittances, in conjunction with the Tobacco Companies continuing payments to the state, result in the state receiving "double" payments for health care costs from the Tobacco Companies. The argument fails, however, because the distributor's initial remittance of the HIF to the state, subject to its full reimbursement from retailers and consumers, cannot reasonably be construed as a "double payment" by the Tobacco Companies. Individual consumers were not parties to, or beneficiaries of, the Settlement Agreement.

The requirement that distributors recover the HIF through their sales transactions does not impair the Agreement at all. First, the release provision is limited to matters involving the Tobacco Companies' "future conduct." *Settlement Agreement Part IIIB.b (A 51).* The obligation to

pay the HIF does not arise from any "conduct" by the Tobacco Companies. It is a regulatory requirement generally applicable to all distributors doing business in the state. Second, the HIF is not a "*monetary claim*" against the distributors because the distributors collect the HIF from their sale of products.

Even if the requirement that distributors remit the HIF to the state is an impairment, it is at most a temporary; not a substantial one. In fact, these "pass-through" arrangements are familiar in tobacco regulation. It was in place in relation to the cigarette tax when the Agreement was entered. Given the extensive level of regulation applicable to distributors under Minnesota law, *see e.g., Minn. Stat.* Ch. 297F and *Minn. Stat.* §§ 325D.30-325D.42, the distributors should have expected that this same method of collection might be used by the state in the future.

Because there is no substantial impairment, the legislation is valid. *See e.g., Acton Cosntr. Co. v. Comm'r of Revenue,* 391 N.W.2d 828, 833-834 (Minn. 1986).

2. The HIF Act Furthers Important Public Policy Interests.

Even if the court were to find a "substantial impairment," the legislation is still valid if it serves a significant and legitimate public purpose such as remedying a broad social or economic problem. *See Energy Reserves Group, Inc.,* 450 U.S. at 412. "The requirement of a legitimate public purpose guarantees that the State is exercising its police powers, rather than providing a private benefit." *Id.* Sufficient public purposes are not limited to emergency or temporary situations. *Id.*

It is indisputable that the purpose of reducing tobacco use (particularly among youths) is a significant and legitimate public purpose. The legislature has specifically found that smoking causes serious, chronic and deadly health conditions and that smoking often begins during adolescence. *Minn. Stat.* § 144.391. The link between the higher retail price for tobacco and the health care costs incurred by the state are likewise strong. Consumers are more likely to recognize the harmful and costly effects of their choices if they are responsible to pay for the costs attributable to their behavior. The HIF Act's requirement that consumers bear the burden of funding the state's health costs encourages changes in consumer behavior.

In addition, the HIF's purpose of funding the state's health costs also reflects a significant public purpose. It is undisputed that the state incurs health costs as a result of tobacco use and must be paid by the state from its revenues. The identification of revenue to offset these costs serves an important public purpose. Without such funding, the costs remain and the state will have to pay these costs out of other state revenues.

The link between, health impacts, increased medical costs and the desire to change consumer behavior are all reflected in the legislature's 1985 findings about smoking. *Minn. Stat.* § 144.391. The HIF reflects the most recent legislative attempt to address these persistent and significant public purposes. Further, the importance of these matters to the legislature is reflected in the penalties for noncompliance. The Commissioner is authorized to revoke a distributors' license for failure to comply with the HIF Act. *HIF § 2, subd. 8. (A. 34).* Criminal penalties could also apply. *Minn. Stat.* § 297F.20.

3. The HIF Act Imposes Reasonable Conditions and Is Appropriate to Achieve the Public Purpose.

If the Court determines that the public purposes served by the HIF Act are significant and important, the Court then examines "the state's action . . . in the light of this public purpose to see 'whether the adjustment of the rights and responsibilities of the contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." *Christensen,* 331 N.W.2d at 751. The HIF Act is a reasonable and appropriate method for achieving the legislature's chosen public purposes.[10]

The HIF was expressly designed to reduce tobacco use, because the revenue generated by the HIF was anticipated to decline as use declined. The use of higher consumer prices is a reasonable and appropriate method of dampening consumer demand for tobacco. In addition, requiring that the consumer's higher price be used directly to offset the state's costs arising from the consumer's choice is also a reasonable and appropriate method to achieve the public purpose. Requiring that the state deposit the HIF funds in the general fund would defeat the

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[10] In *Christensen,* the Court noted that contracts in which the state is a party are subject to stricter scrutiny because of state's "self interest." The HIF does not reflect any attempt by the state to use its legislative police powers for "self-advantage." *Id.*, 331 N.W.2d at 751. In relation to recovery of health costs, the HIF reflects the legislature's desire to hold consumers (not distributors) responsible for these costs. The incidence upon the distributor reflects the state's need for administrative coordination of the HIF with the other cigarette taxes and the substantial existing regulatory structure applicable to distributors. The HIF Act does not in any manner reflect a purpose or intent to permanently impose these costs on distributors.

HIF's purpose of linking consumer behavior to the state's costs arising out of that behavior.

The structure of the HIF to collect the fee at the top of the distribution chain is also a reasonable and appropriate method for the state to achieve the purposes of the HIF. This method of collection is consistent with the extensive regulation of cigarettes at the distributor level under existing law. Given the non-existent or minimal administrative impact to the distributors, prohibiting collection of the fee at the distributor level will result in significant burdens on the state's administration and collection of the HIF.

III. The Court Does Not Need To Decide Whether Minnesota's Health Impact Fee Is A "Fee" Or A "Tax."

The State prevails under the separation of powers analysis and the impairment of contract analysis, regardless of whether the HIF is characterized as a fee, a tax, a hybrid, or something else entirely. As long as the Legislature possessed the valid authority over the subject and the legislation serves an important public purpose, the statute is valid and enforceable.

The legislature has broad authority to enact legislative solutions to meet contemporary problems.

> The legislature is of necessity vested with broad powers to devise ways and means to alleviate adverse and unequal social and economic ills and conditions and to provide for those in want from whatever cause. Such needs have always been matters of public concern and importance and have generally met with prompt and generous

> legislative response. Just what is to be done in any given circumstance evidently must lie within legislative discretion, limited and subject only to constitutional prohibition.

Eldred v. Division of Employment and Sec., Dept. of Social Sec., 295 N.W. 412, 414 (Minn. 1940). The Court should reject the invitation to join a political debate as to the characterization of the legislative powers underlying the HIF statute as a fee versus a tax since it is not necessary to resolve this case.

IV. If The Court Finds Impairment, The Relief Granted Should Be Narrow.

If the Court determines that the HIF Act impairs the Tobacco Companies' substantial contract rights, the Court should require that any remedy be limited to preserve as much of the HIF Act as possible.

In this case, the HIF Act has two express purposes. The Tobacco Companies assert that only the second purpose – the recovery of health costs – violates their rights under the Settlement Agreement. In relation to the Tobacco Companies' distributors, the Court should uphold application of the HIF based on the purpose of reducing smoking, particularly among youths. If necessary, the Court could direct the payments from the Tobacco Companies' distributors to the general fund. This remedy preserves the consumer payments under the HIF Act and permit application of the HIF Act in its current form as to the distributors for the non-settling tobacco companies.

If the Court precludes the state's ability to collect the HIF from the Tobacco Companies' distributors, the Court should expressly preserve the state's ability to collect the

HIF for tobacco products not subject to the Settlement Agreement. The Court should further preserve the state's ability to collect the HIF on the Tobacco Companies' products at the retail level, including the right to retroactively collect the fee at the retail level. The Settlement Agreement only applies to the Tobacco Companies and their distributors. *(A 50).* The release provision of the Settlement Agreement does not apply to retailers who sell the Tobacco Companies' products to consumers.[11] *Id.*

The Act imposes the HIF on multiple levels of transactions involving cigarettes – including the sale or possession of cigarettes in this state with the intent to sell. *HIF § 2, subd. 3(a) (A 33).* If collection is denied at the distributor level, the HIF Act grants the Commissioner the use of the powers enumerated in Minn. Stat. Chs. 297F and 270C. *HIF § 2 subd. 6 (A 34).* These provisions allow the Commissioner to establish procedures, forms and materials to collect the HIF from retailers. *Id.*

If the state's ability to collect the HIF at the retail level is preserved, the Court should deny the Intervenors' claims. The state's continued collection of the HIF from their distributors does not impair their constitutional rights.

CONCLUSION

The Settlement Agreement cannot, and should not, be read to impair the legislature's power to enact the HIF

[11] The Governor outlined the legal basis for the collection of the HIF at the retail level in the Governor's Memorandum in Opposition to the Intervenors' Claims.

Act. Under the separation of powers doctrine, the attorney general may not surrender the regulatory power of the legislature. Further, even if the attorney general could contract to limit future legislative acts, the significant public purposes served by the HIF outweigh any minimal impairment of the Tobacco Companies' rights.

The Court should reverse the decision of the district court and uphold application of the HIF Act to all licensed distributors in Minnesota.

Respectfully Submitted,

Dated: February 16, 2006 /s/ Karen A. Janisch

Karen A. Janisch
General Counsel to
Governor Pawlenty
Atty. Reg. #0236573
130 State Capitol
St. Paul, MN 55155
(651) 296-3391

ATTORNEY FOR AMICUS CURIAE GOVERNOR TIM PAWLENTY

CERTIFICATE OF COMPLIANCE WITH MINN. R. APP. P. 132.01 SUBD. 3

The undersigned certifies that the Amicus Brief submitted herein contains 6,641 words and complies with the type/volume limitations of the Minnesota Rules of Appellate Procedures 132. The Amicus Brief was prepared using a proportional spaced font of 13 pt. The word count is stated in reliance on Microsoft Word 2003.

Dated: February 16, 2006 /s/ Karen A. Janisch

Karen A. Janisch
General Counsel to
Governor Pawlenty
Atty. Reg. #0236573
130 State Capitol
St. Paul, MN 55155
(651) 296-3391

ATTORNEY FOR
AMICUS CURIAE
GOVERNOR TIM
PAWLENTY

[The appendix to this Amicus Brief consisted of the 2005 Budget Summary, House Fiscal Analysis Department, Table 1. It has been omitted for printing.]